



Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

**Conditional Approval #347
January 2000**

**DECISION OF THE OFFICE OF THE COMPTROLLER OF THE CURRENCY
ON THE APPLICATION TO CHARTER
AEROBANK.COM, NATIONAL ASSOCIATION, SAN JOSE, CALIFORNIA
JANUARY 29, 2000**

I. DESCRIPTION OF THE PROPOSAL

On June 15, 1999, a group of organizers (“Organizers”), filed an application with the Office of the Comptroller of the Currency (“OCC”) to charter a new full-service national bank. The proposed bank will be headquartered in San Jose, California, and will be titled AeroBank.com, National Association (“Bank”).¹ The Bank has applied to the Federal Deposit Insurance Corporation (“FDIC”) for deposit insurance and will apply to become a member of the Federal Reserve System. No public comments were received with respect to the application.

The Organizers also propose to establish a bank holding company titled AeroBancorp.com Corporation. The bank holding company will own 100 percent of both the Bank and AeroFund Financial Inc. (“AeroFund Financial”), an existing accounts receivable factoring company owned by one of the organizers. AeroFund Financial and the Bank will share adjacent office space and will share some employees’ time and salaries.²

The Bank will not have any traditional banking offices accessible to the public but will deliver products and services to its customers through a variety of electronic delivery channels.³ Customers will conduct banking transactions through automated teller machines

¹The Organizers are Stephen K. Troy, R. Scott Racusin, Daniel D. Duarte, Gary R. Price, Stephen D. Pahl.

²The OCC requires that the Bank comply with the requirements of 12 C.F.R. § 7.3001 (sharing space and employees) and 12 U.S.C. §§ 371c & 371c-1. Both the Bank and AeroFund Financial will provide products and services primarily to small- and medium-sized businesses. Thus, the Organizers represent that AeroFund Financial will refer some of its customers that will qualify for bankable loans to the Bank, and conversely, the Bank will refer loan applicants to AeroFund when appropriate.

³This is the fourth charter proposal decided by the OCC for a national bank that will deliver products and services to customers primarily through electronic means. See the following OCC preliminary charter approvals: CompuBank, National Association, Houston, Texas, Conditional Approval #253, August 20, 1997, <http://www.occ.treas.gov/interp/sep97/ca253.pdf>; NextBank, National Association, San Francisco, California, Conditional Approval #312, May 8, 1999, <http://www.occ.treas.gov/interp/may99/ca312.pdf>; and CIBC National

("ATMs"), through the Internet via a transactional Web site, and through the Bank's toll free customer service line. The Bank will employ a team of full-time business development officers located throughout the nation. These individuals will generate new business for the bank and manage existing client relationships. However, they will not have the authority to accept deposits or disburse loan proceeds. The Bank will establish its own deposit-taking ATMs in the general geographic areas to be covered by its business development officers.

The business strategy for the Bank is to provide a full array of traditional banking products and services primarily to small- and medium-sized businesses. The focus will be on relationship banking via business development officers in the field, credit analysts at a central location, and customer service agents at a telephone call center. The Bank's credit products will include business loan products such as secured and unsecured term loans, secured and unsecured revolving lines of credit for working capital needs and retail loan products such as secured consumer loans and home equity loans. Deposit-related products and services will include transaction accounts such as demand deposit, interest checking, and money market accounts; certificates of deposit; cash management services; and electronic bill presentment and payment services.⁴

The Bank will allow customers to apply for both loan and deposit accounts online with follow-up documents sent through the mail.⁵ It will use credit scoring to make the credit decisions on consumer loans and small revolving business lines and term loans, but will manually underwrite larger business loans and all real estate loans. The Bank plans to refer customers to a third-party lender for co-branded business and consumer credit cards.

A central component of the Bank's business approach is to establish strategic alliances with third parties of interest to small- and medium-sized businesses. In this regard, the Bank plans to build an electronic commerce Web page with hyperlinks to third-party Web sites offering a wide variety of financial and nonfinancial products and services considered useful to small businesses such as insurance, investment products, credit reports, office supplies, equipment leasing, general ledger services, payroll services, telecommunications, and travel agency services. In offering these hyperlinks, the Bank will be acting in a finder capacity, thus bringing together buyers and sellers of products and services.⁶ The Bank may also

Bank, Maitland, Florida, Conditional Approval #313, July 9, 1999, <http://www.occ.treas.gov/interp/jul99/ca313.pdf>.

⁴To facilitate the offering of the cash management services, the Bank plans to establish a correspondent relationship with a major financial institution which has branches throughout the nation.

⁵The Bank will require customers to return documents such as signature cards, electronic transfer authentications, loan documentation, and credit acceptances through the mail. The Bank's goal over time is to reduce as much of the paperwork as banking regulations will permit.

⁶ The OCC has found that national banks may, as part of the finder authority (see 12 C.F.R. 7.1002), establish hyperlinks between the bank's retail web site and the web sites of third parties. See Conditional Approval No. 221 (December 3, 1996), <http://www.occ.treas.gov/interp/dec/conda221.pdf> (National banks, in the exercise of

negotiate arrangements with the linked third-party Web sites whereby the third-parties will offer reduced rates to Bank customers for products and services.⁷ Although the Bank is designing the electronic commerce component mainly as a value-added service, it also expects to generate fee income through finders fees.

The marketing strategy reflects reliance upon the business development officer network to build the core customer base. Similar to the affiliated AeroFund Financial, the Bank envisions that the business development officers will be the point of entry for most customers. In this sense, it plans to generate most of its customer base the way more traditional "brick and mortar" small business banks do today -- through relationship banking. It will then deliver the products and services, more efficiently and perhaps more

their finder authority, may establish hyperlinks between their home pages and the Internet pages of third party providers so that bank customers will be able to access those non-bank web sites from the bank site) and Interpretive Letter No. ____, [to be published] (October 31, 1999) (National banks may operate a "virtual mall," *i.e.*, a bank-hosted set of web pages with a collection of links to third party web sites organized as to product type and available to bank customers so that bank customers can shop for a range of financial and non-financial products and services via links to sites of third party vendors and merchants can electronically confirm payment authorization before shipping goods).

The OCC expects that the Bank will take reasonable steps to clearly distinguish between products and services that are offered by the Bank and those offered by a third party or Bank affiliate. Bank customers should be able to identify when they are dealing with the Bank and when they are not, and the Bank should indicate that it does not provide, endorse, or guarantee any of the products or services available through the third-party Web sites. Internet technology provides multiple methods to provide such clarity to potential customers; examples include simple text and dialogue boxes. See OCC Banking Bulletin 94-13 (February 24, 1994), <http://www.occ.treas.gov/ftp/bulletin/93-13.pdf>, and "Technology Risk Management: PC Banking," OCC Bulletin 98-38, p. 17 (August 24, 1998); <http://www.occ.treas.gov/bullst98.htm>. The OCC will consult with the Bank on its electronic finder operations as they become more well defined.

⁷ Interpretive Ruling 7.1002, 12 C.F.R. § 7.1002, provides that a national bank's role as a finder includes, "without limitation, identifying potential parties, making inquiries as to interest, introducing or arranging meetings of interested parties, and otherwise bringing parties together for a transaction that the parties themselves negotiate and consummate." The plain language of the Interpretive Ruling supports the Bank's negotiating arrangements with linked merchants to provide reduced rates to Bank customers. One aspect of "making inquiries as to interest" includes inquiring whether a merchant would be willing to provide a discount for Bank customers. Moreover, the Bank, in "otherwise bringing parties together," may reasonably choose to bring together with Bank customers only those merchants who are willing to provide a discount. In other words, one part of making inquiries and bringing parties together is negotiating with merchants as to the terms of compensation for the finder. A reduced rate to be offered to Bank customers can be a form of compensation for the Bank because it will help attract customers to the Bank's services or web site. *Cf.* Letter from Lee Walzer, Attorney, Securities, Investments & Fiduciary Practices Division (August 24, 1992) (unpublished) (bank may negotiate with merchant for finder's fee).

Nor does negotiating arrangements with the linked merchants to provide reduced rates to Bank customers cause the Bank to become involved in the negotiations of the parties and thereby exceed its proper role as finder. The Bank's negotiations with a merchant and the merchant's negotiations with potential buyers are temporally discrete events. The Bank's negotiations with a merchant are completed well before the commencement of any merchant-buyer negotiations. The customer is not a party to these discussions. Indeed, a bank's role as finder stops with the commencement of negotiations between the merchant and buyer. As such, the Bank does not participate in the negotiations between the parties or the consummation of the transaction between the parties.

conveniently, to their customers through electronic delivery channels. The Bank will also reach target companies and individuals through print ads in trade publications and business journals and Web-based advertising through banner ads and the rental of “real estate” on the Web sites with which it has strategic alliance agreements.

The Bank’s main office will be situated in an office suite in San Jose, California. With the exception of the business development officer contacts, the Bank will service all customers through electronic delivery channels. Telephone and Internet banking services will be available 7 days a week, 24 hours a day. Main office staff will consist of a Chairman, President and Chief Executive Officer, Chief Financial Officer, Chief Credit Officer, Chief Technology Officer, two Senior Vice Presidents, Cashier, credit analysts, customer service representatives, and administrative support.

The Bank will perform some key operational functions internally while contracting with third-party service providers for the provision of other functions. Bank staff will perform business and strategic planning, marketing, investment and funds management, loan underwriting, and customer service. The Bank will likely outsource to a third-party service provider for off-peak telephone customer service, the Internet banking platform, item processing, core data processing, bill payment services, card and check production, accounts receivable audit, delinquent loan collection, legal, and internal audit.

As discussed further below, the Bank has opted to be evaluated initially as a large bank for Community Reinvestment Act (“CRA”) purposes. As a large bank, the Bank’s CRA performance will be evaluated under the lending, investment, and service tests. This branchless Bank plans to delineate the San Jose MSA, the area around the Bank’s main office, as the initial assessment area. When the Bank establishes deposit-taking ATMs as planned, it will designate additional assessment areas. In the future, the Bank believes that it may be advantageous to develop and seek prior OCC approval for a CRA strategic plan.

II. LICENSING FACTORS

A. Policy Considerations

Under its Corporate Activities regulations (12 C.F.R. § 5.20), the OCC considers whether the proposed bank: (A) has organizers who are aware of, and understand, national banking laws and regulations; (B) has competent management, including the board of directors, with ability and experience relevant to the types of services to be provided; (C) has capitalization that is sufficient to support the projected volume and type of business; (D) can reasonably be expected to achieve and maintain profitability; and (E) will be operated in a safe and sound manner.

In evaluating this charter proposal, the OCC performed a thorough assessment of the Organizers and the proposed operating plan. This included a field investigation comprised

of interviews with the Organizers and proposed officers and directors; investigation and review of affiliated AeroFund Financial's business record; review of proposed operations; and evaluation of its proposed information system architecture and approach to security and controls. We also conducted a detailed financial and business plan analysis using regulatory and industry data and research.

Organizers and Management

The OCC concluded that the organizers and proposed management and directorate are knowledgeable of, and understand, national banking laws and regulations and safe and sound operations. The Bank plans to have at least ten directors on the board. All of the Organizers will serve as directors and three will also serve as senior executive officers. Five of the directors are outside directors. Their backgrounds include bank technology, accounting, law, real estate, business, and banking. Each director understands the role and responsibilities of a national bank director.

The Organizers are assembling a competent management team with satisfactory experience to run the proposed operations in a safe and sound manner. The proposed President and Chief Executive Officer is R. Scott Racusin, who has 25 years of banking experience and the necessary attributes to implement the operating plan. His two primary employers have been the former Security Pacific National Bank and Bank of California, N.A., and his experiences include operations, middle market and small business lending, credit administration, and management. He has managed several divisions of large banks and rose to the level of Senior Vice President of the Private Bank unit at Bank of California. Satisfactory candidates have been located for the Chief Credit Officer, Cashier, and two Senior Vice President positions, one of which involves strategic alliances with other Internet sites. The Bank is in the process of finalizing selections for the Chief Financial Officer and Chief Technology Officer positions. The Chief Technology Officer should have strong technical and leadership skills in the computer and Internet areas to create a vision for future technology needs. In addition, the Bank plans to hire credit officers with the necessary knowledge, skills, and abilities to develop, implement, evaluate, and monitor the small business and consumer credit scoring aspects. OCC review and no objection for these management positions is a preopening requirement.

Capital Considerations

Proposed capital is sufficient to support the projected volume and type of business. AeroBancorp.com, the proposed bank holding company, plans to provide initial capital to the Bank of \$18 million in cash. Based upon the Bank's growth and earnings projections, the initial capitalization should ensure that the Tier 1 leverage ratio exceeds eight percent throughout the first three years of operations. As outlined below, we have imposed a condition requiring the Bank to maintain this level of capital in the event that earnings or growth differ from the projections in the application. The projections also evidence risk-

based capital ratios that are well in excess of the minimum regulatory requirements.⁸ Furthermore, the Bank will develop and maintain a comprehensive business contingency plan that includes realistic plans for raising additional capital in the future if needed.

Earnings Considerations

The financial projections show the Bank becoming profitable within three years using realistic growth, income, and expense assumptions. It is reasonable to expect that the proposed Bank can achieve and maintain profitability in line with these projections. The Organizers supported the profit prospects of this strategy by including an independent feasibility study in the application. The proposed Bank will focus on a niche market, the small- and medium-sized business market. It plans to offer banking products and services to meet all of the target customer's business and personal banking needs, including loans, deposits, bill payment, and cash management, as well as act as a finder to enable unaffiliated third parties to provide products and services to meet a small business' everyday needs, ranging from insurance to payroll services to office supplies. The Bank will underwrite and carry its own loans, something that few Internet-only banks do at this time, thus, generating loan interest income. Further, the Bank plans to generate noninterest income in the form of finders fees from the third-party product and service providers. On the funding side, the Bank initially will be subject to the market conditions for Internet-only banks, which tend to price their deposits higher than traditional "brick and mortar" banks. However, as the Bank expands its customer relationships and establishes conveniences such as proprietary ATMs, it is reasonable to expect that the Bank's deposit mix will shift more towards business demand and other deposits, reflecting its core desired customer base. This should cause its funding costs to decrease.

Other costs for the proposed Bank fall between those of its Internet and traditional "brick and mortar" competitors. The Bank's plan to bridge the "virtual world" with the "real world" using business development officers and ATMs will likely result in a higher cost structure than Internet-only banks that offer no physical presence or staff dedication for customers. However, an often cited study concluded that telephone call centers, ATMs, and the Internet are significantly lower cost delivery channels than branches.⁹

There are reasonable prospects that the Bank will attract its proposed customer base. Individuals are already displaying a strong desire for Internet banking services. Several recent studies estimate that online banking households in the United States currently total

⁸See 12 C.F.R. Part 3.

⁹See "Consumer Demand for Internet Banking," Booz Allen & Hamilton, July 1996, III-5F.

between 6 million and 8 million and project they could grow to 20 million or more in the next few years.¹⁰

Safety and Soundness Considerations

The OCC is satisfied that the Bank will be operated in a safe and sound manner. Based upon preliminary review, the Organizers have established a good foundation of personnel, policies, and controls that will be adopted by the Bank. The OCC will confirm this during the preopening examination that will be broad in scope and conducted by an interdisciplinary team. This examination will include an evaluation of the Bank's final plans to identify, monitor, and control all relevant risks, notably transaction risk stemming from Bank's use of technology and other operational factors, credit risk, interest rate risk, liquidity risk, strategic risk, reputation risk, and compliance risk.

As part of the operating plan submitted to the OCC, the proposed Bank has developed a description of its information systems architecture. This includes a discussion of the technologies used and key elements for the security controls, internal controls, and audit procedures. Based upon our review of the plans, the OCC is satisfied with the plans to date, but will undertake further review during the organizational phase of the Bank. Prior to receiving final charter approval, we are requiring the Bank to submit the final information system and operations architecture plans for the OCC's review and approval. In addition, before implementation, the Bank's computer system must successfully undergo a comprehensive security review by an objective and qualified source, including adequacy of protection against unauthorized external access. The Bank must adhere to current and future OCC issuances on technology risk management.¹¹

As discussed above, the Bank has submitted draft plans to perform some key operational functions internally while contracting with third-party service providers for the provision of other functions. Prior to receiving final charter approval, we are requiring the Bank to finalize such plans and establish acceptable policies and processes for vendor management, including with respect to operational oversight and quality assurance.

Based upon our review of the Bank's draft lending plan and credit policy to date, we are satisfied that the Organizers will put into place the necessary and appropriate personnel, policies, procedures, underwriting standards, management information systems, and controls. Nonetheless, we will undertake an in-depth review of this area during the organizational phase of the Bank. The Bank will use credit scoring models developed by an

¹⁰Compilation of studies by Gartner Group, Forrester Research, Inc., Piper Jaffray, and Data Quest.

¹¹See "Internet Banking," Comptroller's Handbook (October 1999) and "Technology Risk Management: PC Banking," OCC Bulletin 98-38 (August 24, 1998), <http://www.occ.treas.gov/bullst98.htm>.

industry leader to make decisions on consumer loans and small revolving business lines and term loans. It is in the process of hiring several loan officers with the requisite credit scoring knowledge and skills. As a precautionary measure and until it is satisfied that the credit scoring models are resulting in accurate credit decisions, the Bank will manually underwrite all loans in parallel with the credit scoring models. Prior to granting final charter approval, we are requiring that the Bank submit for review and approval a comprehensive description of its final lending plan and credit policy with respect to all stages of the lending process. Furthermore, the Bank must implement an independent credit review function that is appropriate for the size and scope of the lending activities.

The proposed Bank intends to minimize potential fraud losses by applying robust fraud management techniques. This includes computer-based and manual procedures for identity authentication and background verification of customers who apply online. Consistent with the standard requirement for all new bank charters, the Bank will develop and implement comprehensive Bank Secrecy Act and anti-money laundering policies and procedures prior to opening.

The OCC recognizes that the market segment comprised of “Internet-only” financial institutions largely remains in its infancy. Accordingly, the market competitors, individually and as a group, have not yet achieved consistent and sustained growth and profitability. Furthermore, the marketing, delivery, and pricing of Internet banking products and services continues to evolve. To help manage and control the interest rate, funding, and overall strategic risks of this marketplace, we are requiring that the Bank develop a comprehensive business contingency plan and integrate it into the business and strategic plans and the funds management policy. The objective of the business contingency plan is to help ensure that the Bank can prudently, efficiently, and effectively manage potential scenarios where the loan or deposit mixes, interest rates, operating expenses, marketing costs, and/or growth rates differ significantly from the original plans. This includes access to additional capital in the future if situations dictate and contingency funding plans that address strategies for managing potential liquidity fluctuations. The Bank should update the business contingency plan periodically, including as the Bank becomes more complex and as industry conditions change.

The proposed Bank will draft and implement a comprehensive privacy policy.¹² The Organizers represent that the policy will inform the customer what information is being collected, why it is being collected, how it is being used, and with whom it is shared. The Bank will provide a direct link to its privacy policy from the home page of its Web site and

¹²The OCC has issued guidance for national banks on examples of effective practices for informing customers over the Internet about bank policies for the collection and use of personal information. The guidance discusses examples of effective practices for the development of bank privacy policies and measures for ensuring adherence to those policies. See “Guidance to National Banks on Web Site Privacy Statements,” OCC Advisory Letter 99-6, May 4, 1999, <http://www.occ.treas.gov/advlst99.htm>.

from Web pages where personal information is collected.¹³ The Bank will maintain internal controls, including technological firewalls, to preclude unauthorized access to or disclosure of customer information. In addition, management will be integrally involved in privacy policy development, and the Bank will develop and implement processes, including audit, to ensure employee understanding and adherence to its stated policy.

At the preopening examination, the OCC will review the Bank's policies, procedures, and controls for ensuring compliance with consumer protection laws and regulations. This review will include confirmation that adequate policies have been implemented in these areas. The OCC also expects that the Bank's policies and procedures will comply with current and future guidance issued by the OCC and the FFIEC with respect to customer privacy, consumer protection, and electronic banking.¹⁴

The proposed Bank has represented that its internal systems are Year 2000 compliant and that it is performing sufficient due diligence and testing to ensure that third-party data processing services or purchased applications and systems from software vendors will also be Year 2000 compliant.¹⁵ In any case, the Bank will open after the century date change.

Finally, the Organizers represent that the Bank will not indicate in any of its marketing efforts or materials that the OCC has approved or endorsed the security, functionality, or effectiveness of the Bank's products or services.

The OCC believes that the Bank has a reasonable chance for success and can be adequately supervised using established safety and soundness and bank information system examination

¹³The policy states that the Bank collects confidential customer data to determine customer suitability for a loan or deposit product. The Bank will not share confidential customer information with third parties, including Web link alliances, except under limited circumstances. One such circumstance includes sharing with a service provider when it is a necessary step in completing a customer transaction. In those cases, the Bank will ensure that the service provider's privacy policies are at least as stringent as the Bank's and that the information is subject to a confidentiality provision in the Bank's contract with the service provider. The only other circumstances are reporting to credit bureaus, responding to a judicial subpoena, or as otherwise required by applicable law. The Bank will obtain the customer's consent before sharing his or her name with an unaffiliated third party, and provide the customer an opportunity to "opt-out" of the Bank's sharing of customer information with an affiliate for the purpose of cross-selling other products or services.

¹⁴See OCC Bulletin 98-31 (FFIEC Guidance on Electronic Financial Services and Consumer Compliance), OCC Bulletin 98-38 (Technology Risk Management: PC Banking), and OCC Advisory Letter 99-3 (Fair Credit Reporting Act).

¹⁵See "Year 2000 and Systems Integration Considerations in Corporate Application Decisions," OCC Advisory Letter 98-1 (January 20, 1998), <http://www.occ.treas.gov/advlst98.htm>, and OCC Advisory Letter 99-5 (May 3, 1999), <http://www.occ.treas.gov/advlst99.htm>.

procedures.¹⁶ Before the Bank receives its final charter approval, the OCC will conduct a thorough preopening examination of the Bank, including its information systems environment, policies, procedures, controls, and compliance with all standard and special preopening requirements and conditions.¹⁷

B. Legal Considerations

1. Chartering authority

The OCC charters a national bank under the authority of the National Bank Act of 1864, as amended, 12 U.S.C. § 1 *et seq.*, and 12 C.F.R. 5.20. The OCC has conducted a thorough review of this application in light of the factors set forth in these statutory and regulatory provisions and has determined that there is no impediment under applicable laws and regulations to granting preliminary charter approval.¹⁸

2. Authority over vendors

As discussed, the Bank has indicated in its application that certain functions of its internal operations will be contracted out to various vendors. The process of subcontracting activities that the Bank would otherwise perform for itself implicates the requirements of the Bank Service Company Act, 12 U.S.C. 1861 *et seq.* (“BSCA”).¹⁹ In particular, 12 U.S.C. 1867(c) states, in part, that

[n]otwithstanding subsection (a) of this section, whenever a bank that is regularly examined by an appropriate Federal banking agency, or any subsidiary or affiliate of

¹⁶See “Internet Banking,” Comptroller’s Handbook (October 1999).

¹⁷The Bank’s operating plan, including any future enhancements, additions, or changes, will provide the context for the supervisory review during the preopening examination. Major deviations from the operating plan, including increases in the riskiness of the operations, or changes in the composition of the board of directors, ownership, or executive officers that the OCC has not approved may result in an amendment to or withdrawal of preliminary conditional approval.

¹⁸With regard to chartering a national bank, the National Bank Act requires that: articles of association and an organization certificate must be drafted and filed with the OCC, 12 U.S.C. §§ 21-23; the required amount of capital must be paid in, 12 U.S.C. § 53; certain requirements relating to directors must be satisfied, 12 U.S.C. §§ 71-73; and the OCC must be notified when these things have been accomplished, 12 U.S.C. § 26. As is typical with new charter proposals, these requirements will be satisfied after the OCC grants preliminary approval. We note that the Bank also must obtain deposit insurance from the FDIC and the establishment of the AeroBancorp.com must be approved by the Federal Reserve System under the Bank Holding Company Act. The Bank has filed an application for deposit insurance with the FDIC, and represents that it will soon file its bank holding company application with the Federal Reserve Bank of San Francisco.

¹⁹The BSCA requires that the Bank notify the OCC of the existence of the service relationship within thirty days after the making of such service contract or the performance of the service, whichever occurs first. 12 U.S.C. § 1867(c)(2).

such a bank that is subject to examination by that agency, causes to be performed for itself, by contract or otherwise, any services authorized under this chapter, whether on or off its premises - (1) such performance shall be subject to regulation and examination by such agency to the same extent as if such services were being performed by the bank itself on its own premises

Pursuant to this statute, services performed for the Bank by contract or otherwise, will be subject to the examination and regulation of the OCC. The Bank has represented that it will notify potential vendors, in writing, of the OCC's examination and regulatory jurisdiction should they contract with the Bank. This understanding regarding OCC jurisdiction will be included in all vendor contracts. Accordingly, subcontracting functions to a vendor will not frustrate the OCC's ability to regulate all aspects of the Bank that could affect its safe and sound operations.²⁰

3. Other Legal Matters

There are no branching issues raised in this application. *See generally* 12 U.S.C. § 36(c). The Bank has represented that no business development officers or anyone outside of the main office of the Bank will have the authority either to accept deposits or to approve any type of credit transactions. Furthermore, loan proceeds will be disbursed by electronic transfer to a deposit account held at the Bank.

With respect to affiliate transactions, the Bank has represented that it, AeroBancorp, and AeroFund Financial each will develop an affiliate transactions policy and implement appropriate training to enable senior management of the respective companies to identify potential transactions with, or deemed to be with, an affiliate that may be subject to the affiliate transaction statutes, 12 U.S.C. §§ 371c and 371c-1. Additionally, it is anticipated that, prior to engaging in any proposed transaction with an affiliate, an officer of the Bank will review any such transaction to ensure compliance with the affiliate transaction statutes.

C. Community Reinvestment Act Considerations

Under the Community Reinvestment Act ("CRA") and its implementing regulations, the OCC must take into account a proposed insured national bank's description of how it will

²⁰Elements of the services to be provided to the Bank may be performed by third party vendors through the parent bank holding company, AeroBancorp.com ("BHC"). These services will constitute activities pursuant to the BSCA. To the extent that third party vendors perform these services for the Bank through the BHC, the third party vendors will be subject to federal banking regulation and examination to the same extent as if such services were being performed by the Bank itself. Similarly, to the extent that the BHC itself performs services for the Bank, those services will be subject to the BSCA.

meet its CRA objectives.²¹ Twelve C.F.R. § 5.20(h)(5)(ii) requires an organizing group to submit a CRA statement that demonstrates its plans to achieve CRA objectives as part of its proposed operating plan. The Bank has provided an operating plan that includes such a description. The Bank has opted to be evaluated initially as a large bank for CRA purposes.²² As a large bank, its CRA performance will be evaluated under the lending, investment and service tests set forth at 12 C.F.R. §§ 25.22 through 25.24. Because it will be evaluated as a large bank under CRA, the Bank will collect and report the data required by 12 C.F.R. § 25.42.

The Bank plans to help meet the credit needs of its assessment area(s) through its lending activities, qualified investments, and retail and community development banking services. As discussed previously, the Bank will provide its commercial banking and financial services and products to businesses and individuals through the Internet, as well as other alternative delivery channels, including telephones, faxes and United States mail. Due to the Bank's strategy of providing services primarily as an Internet bank, it is likely that many of the Bank's customers will be located throughout the country. However, the Bank's CRA plan indicates that each commercial customer will be assigned a business development officer in its geographic territory as well as a customer care representative located in San Jose, California. The Bank also intends to offer numerous deposit-taking ATMs across the country for the convenience of its customers. To that end, it initially intends to install ATMs in the cities in which business development officers are located.

The Bank plans to offer commercial and consumer loans and services. Its commercial loan products will include revolving lines of credit for accounts receivable and inventory financing, term loans, loans secured by real estate and occupied by the business for its offices, and SBA loan products. In addition, the Bank's affiliate, AeroFund Financial, makes loans to small businesses in which the Bank will occasionally participate. The Bank's consumer loan product offerings will include home equity lines of credit, secured and unsecured personal credit lines, term loans, and overdraft protection. The Bank does not intend to originate home mortgage loans, but may purchase them. It will also offer a full array of deposit products to individuals and businesses.

To help meet the credit needs of low- and moderate-income ("LMI") areas and individuals, AeroBank intends to ensure that a reasonable percentage of its small business loans are in LMI geographies and that a reasonable percentage of its purchased home mortgage loans are to LMI borrowers and/or are located in LMI areas. The Bank also intends to help meet credit needs through community development lending. According to its plan, the Bank intends to establish relationships with local and regional community organizations to

²¹ See 12 U.S.C. 2902(3) and 2903(a)(2) and 12 C.F.R. 25.29(b).

²² However, the Bank's operating plan notes that in the future the Bank may develop a CRA strategic plan and seek regulatory approval of such plan from the OCC.

ascertain community development needs and to identify community development lending opportunities. As community development services, the Bank intends to make financial service technology more accessible to small businesses within its assessment area(s) and to provide small businesses with technical assistance. The Bank further intends to meet the needs of its assessment area(s) through qualified investments, potentially including targeted mortgage-backed securities.

As set forth in 12 C.F.R. § 25.41(c)(2), the Bank must delineate assessment areas that “include geographies in which the bank has its main office, its branches, and its deposit-taking ATMs, as well as the surrounding geographies in which the bank has originated or purchased a substantial portion of its loans” The Bank’s main office will be located in San Jose, California. As such, the Bank’s plan to designate the San Jose MSA as its initial assessment area is appropriate. Although the Bank will not have any branches, it plans to install deposit-taking ATMs at numerous sites, beginning with the cities in which its business development officers are located. In accordance with the requirements of the CRA regulations, the Bank will designate additional assessment areas where it establishes its deposit-taking ATMs.

Based upon the foregoing, the OCC believes that the Bank’s plan for meeting its CRA objectives is consistent with preliminary approval of this charter application.

III. PREOPENING REQUIREMENTS AND SUPERVISORY CONDITIONS

In all cases, following review of a new bank charter application, the OCC decides whether to grant preliminary approval, preliminary conditional approval, or disapproval to the request. Preliminary approval indicates permission to proceed with the organization of the bank according to the plan set forth in the application. The organizational steps of a new national bank generally include hiring management and staff, establishing premises, purchasing computers and other equipment, selecting vendors, developing and implementing policies, procedures, and controls, and raising capital. Preliminary approval is not an assurance, however, that the OCC will grant a new national bank charter. Once the OCC grants preliminary approval to a charter proposal, the organizing group must satisfy certain procedural requirements, and, in some cases, special requirements before the OCC will grant final charter approval. In addition, the OCC sometimes imposes conditions that will remain in place after the bank opens.

In response to this proposal, the OCC grants preliminary conditional approval subject to several preopening requirements and on-going conditions. These supplement the procedural requirements for a new national bank referenced in the transmittal letter to the Bank’s spokesperson. The preopening requirements provide a framework for steps that the proposed Bank must successfully complete before the OCC can render a decision on final charter approval. The on-going conditions primarily establish certain checks and safeguards to ensure that the Bank, once open, will maintain adequate capital and operate in an overall

safe and sound manner. The capital condition and prior notice of significant operating plan changes condition expire after three years. The OCC will monitor the Bank's future actions and performance through the normal supervisory process.

In addition to the procedural requirements for all new national banks, the following requirements must be satisfied before the OCC will grant final charter approval:

1. The Bank's initial Tier 1 capital, net of any and all organizational and preopening expenses, must be no less than \$17.5 million.
2. The Bank must submit to the OCC for review and approval a complete description of the Bank's final proposed information systems and operations architecture. This should include a schematic drawing and discussion of the following items: vendors; due diligence performed on the third-party vendors; vendor contracts; system and data security mechanisms; operating processes; vendor management policies and procedures; internal controls; and internal audit plans.
3. The Bank must submit to the OCC for review and approval a comprehensive description of the Bank's final lending plan and credit policy. This should include, but not be limited to, loan types, size, and pricing/profitability models; underwriting standards including credit scoring cutoffs and change strategies; credit origination procedures; collateralization and collection policies and procedures; credit scoring model validation, performance monitoring, and redevelopment procedures; management information systems; loan review; and employee compensation programs.
4. The Bank must develop a business contingency plan and integrate it into the business and strategic plans and funds management policy. The Bank must submit the business contingency plan to the OCC for review and approval. The objective of the business contingency plan is to help ensure that the Bank can prudently, efficiently, and effectively manage potential scenarios where the loan or deposit mixes, interest rates, operating expenses, marketing costs, and/or growth rates differ significantly from the operating plan. This includes access to additional capital in the future if situations dictate and a contingency funding plan that address strategies for managing potential liquidity fluctuations. The Bank should update the business contingency plan periodically, including as the Bank becomes more complex and as industry conditions change.
5. The Bank must have performed an independent security review and test of its Internet bank platform. The Bank must have this review performed regardless of whether the platform is operated in-house or by one or more third-party service providers. This review must be conducted by an objective, qualified internal or external source ("Reviewer"). The scope must cover adequacy of protection against

unauthorized external access including individual penetration attempts, computer viruses, denial of service, and other forms of electronic access. In addition, the review must assess the adequacy of internal security. By written report, the Reviewer must confirm that the security measures, including the firewall, have been satisfactorily implemented and tested. The report must critique the effectiveness of security policies and controls and confirm, with reasonable certainty, that unauthorized internal or external data and network access or access attempts are detected and recorded. As part of its decision to grant final charter approval, the OCC will consider the results of the report as well as any subsequent actions by the Bank or service provider to implement any recommendations or to remedy any noted security or control deficiencies.

6. As proposed, the Bank must name individuals to serve as the Chief Technology Officer and Chief Financial Officer. The OCC must review and have no objection to these individuals, who will be deemed Senior Executive Officers for purposes of 12 C.F.R. Part 5.
7. As proposed, the Bank must name at least two individuals to serve as credit officers with the necessary knowledge, skills, and abilities to develop, implement, evaluate, and monitor the small business and consumer credit scoring aspects of the lending operations. The OCC must review and have no objection to these individuals.
8. The Bank must implement an independent credit review function that is appropriate for the size and scope of the lending activities.
9. The Bank must develop and implement a bank-wide disaster recovery contingency plan pursuant to OCC and FFIEC interagency guidelines.
10. The Bank must implement an independent internal audit function that is appropriate for its size and for the scope of its activities. The internal audit function should be supervised and staffed by individuals with sufficient technology and small business lending expertise to identify the risks inherent in the Bank's operations and to assess the effectiveness of internal controls.

Final approval will be subject to the following conditions:

1. During its first three years of operations, the Bank shall at all times maintain a ratio of Tier 1 capital to adjusted total assets, as defined in 12 C.F.R. § 3.2, in an amount that is equal to or greater than 8.0 percent.
2. The Bank must notify all potential vendors in writing of the OCC's examination and regulatory authority under 12 U.S.C. § 1867(c). All final vendor contracts must

stipulate that the performance of services provided by the vendors to the Bank is subject to the OCC's examination and regulatory authority.

3. During the Bank's first three years of operations, the Bank must provide a minimum of thirty days prior notice to the OCC's San Francisco Field Office before implementing any significant changes to its proposed operating plan.

The above-listed conditions of this approval shall be deemed to be "condition[s] imposed in writing by the agency in connection with the granting of any application or other request" within the meaning of 12 U.S.C. § 1818(b)(1).

V. CONCLUSION

The charter proposal satisfies the applicable statutory requirements of the National Bank Act and the policy standards of the OCC, as set forth in 12 C.F.R. § 5.20. For the reasons set forth above, including the representations and commitments made by the Organizers, it is my conclusion that this proposed national bank has a reasonable likelihood of success. Accordingly, the application is preliminarily approved, subject to the requirements and conditions outlined in this Decision Document and the transmittal letter.

If you have questions regarding this decision, please contact John W. Graetz, Licensing Expert/Financial Analyst, in Bank Organization and Structure at (202) 874-5060.

/s/
Julie L. Williams
First Senior Deputy Comptroller and
Chief Counsel

01-29-2000
Date

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