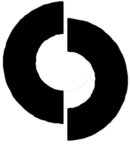

Comptroller of the Currency
Administrator of National Banks
Washington, DC 20219

April 21, 1998

Corporate Decision #98-26
June 1998

Larry Davis
President
Southwest Kansas National Bank
P.O. Box 967
Ulysses, KS 67880

Re: Southwest Kansas National Bank performing title abstracting services through its subsidiary, Southwestern Service, Inc.
Application Control No. 97-WO-08-0005

Dear Mr. Davis:

On July 1, 1997, the OCC approved the acquisition of Southwestern Savings and Loan by Southwest Kansas National Bank ("Bank"), and the retention of the company's operating subsidiary, Southwestern Service, Inc. ("SSI"). The OCC approved certain activities of SSI, including the provision of title abstracting services in connection with extensions of credit originated or purchased by the Bank. However, the OCC required SSI to terminate, within two years, its title abstracting services both for other lenders and for those customers who are not also borrowing money unless, within that time, the OCC determined that these activities are permissible. As explained below, we find these activities permissible for a national bank. Therefore, the OCC approves the Bank's plan for SSI to provide title abstracting services for unaffiliated lenders, and for the occasional customer who requests the service even though there is no associated loan transaction.

Background

When properly staffed, SSI will perform title abstracting services for mineral and gas interests in Kansas. As you explained in telephone conversations with OCC staff, SSI will provide these services in connection with loans by the Bank and by unaffiliated lenders. In addition, you anticipate SSI would prepare a title abstract for the occasional customer who requests one even though there is no associated loan transaction. The Bank represented that no more than ten percent of its requests for title abstracting services will ever be of this nature. Furthermore, SSI would not specifically target such persons in its offering of title abstracting services; however, turning them away because they are not seeking a loan or another banking product could hurt the Bank's reputation for service. You further explained that few, if any, other firms in the area

provide abstracting services for mineral and gas rights, despite the significant demand.

Title abstracting begins with a title search, which is a thorough review of the public property records affecting the ownership interests in the real estate.[1] The records consist of titles, transfers of title, liens, judgments, and other documents affecting the legal title to the real estate. Having reviewed and copied the relevant records, the abstracter compiles the records into an abstract and certifies that the abstract is complete. The abstract is then reviewed by an attorney, who prepares a report of title. SSI will not prepare the reports of title, but will only perform the title search and prepare the title abstract, which explains the legal status of the various ownership interests in the real estate. This service does not involve sale of title insurance; however, it is possible that the abstracter could be liable for negligence if the abstract is incomplete.

Discussion

A. Statutory Framework

The National Bank Act provides that national banks shall have the power:

> To exercise . . . all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes[.]

12 U.S.C. § 24(Seventh).

The Supreme Court has expressly held that the "business of banking" is not limited to the enumerated powers in 12 U.S.C. § 24(Seventh), but encompasses more broadly activities that are part of the business of banking. See NationsBank of North Carolina, N.A. v. Variable Life Annuity Co., 513 U.S. 251, 258 & n.2 (1995) ("VALIC"). The VALIC decision further established that banks may engage in the activities that are incidental to the enumerated powers as well as the broader "business of banking."

Prior to VALIC, the standard that was often considered in determining whether an activity was incidental to banking was the one advanced by the First Circuit Court of Appeals in Arnold Tours, Inc. v. Camp, 472 F.2d 427 (1st Cir. 1972) ("Arnold Tours"). The Arnold Tours standard defined an incidental power as one that is "convenient or useful in connection with the performance of one of the bank's established activities pursuant to its *express* powers under the National Bank Act." Arnold Tours at 432 (emphasis added). Even prior to VALIC, the Arnold

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[1] Kansas law provides that "real estate" includes "not only the land itself, but all buildings, fixtures, improvements, mines, minerals, quarries, mineral springs and wells, rights and privileges appertaining thereto." Kansas Stat. Ann. § 79-102 (1989).

Tours formula represented the narrow interpretation of the "incidental powers" provision of the National Bank Act. Interpretive Letter 494 (December 20, 1989), reprinted in [1989-1990 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,083. The VALIC decision, however, has established that the Arnold Tours formula provides that an incidental power includes one that is convenient and useful to the "business of banking," as well as a power incidental to the express powers specifically enumerated in 12 U.S.C. § 24(Seventh). Finally, national banks may engage in activities that are part of, or incidental to, the business of banking by means of an operating subsidiary. 12 C.F.R. § 5.34(d) (1997).

National banks have the express power to make loans secured by real estate and personal property. 12 U.S.C. §§ 24(Seventh) and 371. In making secured loans, banks need to ensure that their security interests constitute valid and enforceable liens on the property and to determine whether there are other senior liens encumbering the property. The standard way to do this is through a search of title records and production of a title abstract. Title abstracting is a necessary step in the safe and sound credit underwriting process for secured real estate lending. Many banks therefore find it convenient and useful to do the title abstracting themselves. Therefore, the OCC has approved title searching and abstracting by national banks in connection with their lending activities. See Corporate Decision No. 97-13 at 36 (Feb. 24, 1997); Interpretive Letter No. 450 (Sep. 22, 1988), reprinted in [1988-89 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,674.[2]

B. Correspondent Services to Other Financial Institutions are Part of the Business of Banking

SSI may provide title abstracting services to other financial institutions as part of the business of banking because doing so constitutes a valid correspondent banking function. National banks have traditionally performed for other financial institutions an array of activities called "correspondent services." United States v. Citizens and Southern Nat'l Bank, 422 U.S. 86, 114-15 (1975); see also Interpretive Letter No. 811 (Dec. 18, 1997) (permitting national bank to offer printing services to other financial institutions as correspondent service); Corporate Decision No. 97-79 (July 11, 1997) (federal flood hazard determinations); Interpretive Letter No. 467 (Jan. 24, 1989), reprinted in [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,691 (real estate appraisal services to other financial institutions). These correspondent activities are part of the business of banking. Interpretive Letter No. 811 (Dec. 18, 1997); Interpretive Letter No. 754 (Nov. 6, 1996), reprinted in [1996-1997 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,118.

Interpretive Letter No. 467, supra, approved an operating subsidiary to perform real estate appraisals as a correspondent service for other financial institutions. In doing so, the letter explained: "The performance of real estate appraisals for a bank's own loans is an activity

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[2] See also Letter from John E. Shockey, Deputy Chief Counsel (Sep. 20, 1976) (unpublished); cf. 1995 Fed Res Bulletin 805 (abstracting title is "closely related to banking as to be a proper incident thereto" under Bank Holding Company Act for bank borrowers).

traditionally engaged in by banks. Such appraisals are obviously a necessary element of real estate lending. . . . Thus, a national bank may perform real estate appraisals . . . for other financial institutions pursuant to 12 U.S.C. § 24(Seventh)." Likewise here, title abstracting is a necessary element of secured lending and SSI may perform these determinations for other financial institutions as well as for the parent Bank.

C. Excess Capacity

Finally, the Bank would also like SSI to prepare title abstracts for the occasional customer who requests one even though there is no associated loan transaction. SSI will not specifically target such customers in its marketing of its abstracting services and the Bank represented that these non-loan customers will always amount to a very small proportion of SSI's customer base. Nevertheless, turning them away because they are not seeking a loan or another banking product could hurt the Bank's reputation for service. To the extent that providing abstracting services for these customers would not be part of the business of banking, it would nonetheless be a permissible use of SSI's retained excess capacity.

The OCC and the courts have long held that a bank may make profitable use of excess capacity if the bank acquired the excess capacity in good faith to meet either its needs or the needs of its customers. The underlying justification of the excess capacity doctrine is essentially that of avoidance of economic waste. If a bank must leave its asset underutilized, the bank would fail to obtain full economic value from the asset, thus incurring economic waste. However, utilization of the excess capacity permits the bank to reduce the costs of performing those services which are part of the banking business. In turn, this makes its banking business more profitable and competitive. See, e.g., Interpretive Letter No. 811 (Dec. 18, 1997).

For example, in the leading case of Brown v. Schleier, 118 F. 981 (8th Cir. 1902), aff'd 194 U.S. 18 (1904), the national bank leased land on which it constructed a building for its banking activities. Due to its prime location, the land was very valuable as commercial real estate and the bank built an eight-story building from which it leased out several floors for non-banking uses. The court found the bank had the authority take advantage of the economic value of its lease-hold because the bank had acquired the land in good faith. See id. at 984; see also Wingert v. First Nat'l Bank, 175 F. 739 (4th Cir. 1909); Perth Amboy Nat'l Bank v. Brodsky, 207 F.Supp. 785 (S.D.N.Y. 1962).

Similarly, the OCC has approved national banks' sale of excess capacity in a variety of situations and circumstances. 12 C.F.R. § 7.1019; Interpretive Letter No. 811, supra (excess capacity in printing services); Interpretive Letter No. 742 (Aug. 19, 1996), reprinted in [1996-97 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,106 (excess capacity in Internet access); Interpretive Letter No. 677 (June 28, 1995), reprinted in [1994-95 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,625 (excess capacity in equipment, personnel, and facilities for production and distribution of non-financial software); No-Objection Letter No. 89-04 (July 11, 1989), reprinted in [1989-90 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶83,061 (excess capacity in

messenger services); Interpretive Letter No. 137 (December 27, 1979), reprinted in [1981-82] Fed. Banking L. Rep. (CCH) ¶ 85,218 (excess capacity in financial counseling services).

In this case, the Bank clearly acquired the excess capacity in good faith for banking purposes. First, the Bank's needs for title abstracting services will undoubtedly fluctuate. Second, the Bank represented that it will not specifically target non-loan customers and that non-loan customers will never account for more than ten percent of its abstracting business. The acquisition of SSI and its attendant excess capacity was made in good faith to meet the needs of the Bank, its customers, and correspondent financial institutions, not the needs of the general public. Therefore, SSI's title abstracting capabilities were acquired in good faith for banking purposes, and SSI may market and sell its excess capacity to third parties.

Conclusion

Based on the representations above, I conclude that SSI may perform title abstracting services for mineral and gas interests in connection with the Bank's secured lending activities and as a correspondent service offered to other financial institutions. Furthermore, SSI may perform title abstracting services for the occasional customer who is not also borrowing money, provided SSI continues to comport with the representations summarized above relating to excess capacity.

If you have any questions, please contact Steven V. Key, Attorney, Bank Activities and Structure Division, at (202) 874-5300.

Sincerely,

/s/

Raymond Natter
Acting Chief Counsel