



Office of Thrift Supervision  
Department of the Treasury

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MEMORANDUM FOR JOHN PRICE  
ACTING ASSISTANT DIRECTOR FOR POLICY

FROM: Carolyn B. Lieberman  
Acting Chief Counsel *CB Lieberman*

SUBJECT: Overseas Agency Offices

I. Introduction and Summary of Conclusions

On March 8, 1994, [REDACTED] (the "Association"), filed an application with the West Region requesting authorization to establish agency offices in London, England, and Sydney, Australia. The activities of the agency offices will be limited to performing clearinghouse functions to facilitate trust services that the Association proposes to provide to U.S.-based institutional trust customers whose accounts are to be transferred to the Association from its affiliate, [REDACTED] (the "Bank"). The Bank currently provides these clearinghouse functions through Bank branches located in London and Sydney.

In connection with the West Region's review of the Association's application, we have been asked to review whether the OTS has legal authority to approve foreign agency offices of the type proposed by the Association. For the reasons set forth below, we conclude that the Association may lawfully establish agency offices as it has proposed, provided that OTS staff are satisfied that the agency offices will not endanger the Association's safety and soundness.

II. Background

A. Services To Be Offered By The Agency Offices

The Association proposes to provide four categories of clearinghouse services through its foreign agency offices: global custody services, securities lending, paying agent services, and CEDEL depository services. The Association represents that having a limited physical presence in key foreign markets and time zones is essential to the Association's ability to effectively conduct foreign securities and currency transactions on behalf of institutional trust customers. It is not feasible to handle the mechanics of these transactions by long distance communications

alone. Accordingly, if the Association were unable to offer these services directly through an agency office, it would be compelled to contract with a third party to provide such services in order to maintain a level of service for its customers that is comparable to that offered by the Association's competitors.

Each of the services the Association proposes to provide through its foreign agency offices is described in greater detail below.

1. Global Custody Services

As part of its trust operations, the Association intends to provide global custody services to foreign and U.S.-based customers, including broker-dealers, investment managers, private institutions and other members of the public. It is thus anticipated that the agency offices, among other things, will render services such as reporting to customers regarding their holdings of different types of currencies; analyzing and tracking of claims made to foreign nations for tax refunds; settling customer instructions to purchase and sell securities; collecting dividend interest and other sources of income on behalf of customers, and related processing services; assisting customers in foreign exchange transactions; and providing related recordkeeping, reporting and bookkeeping services. The Association will at times provide intra-day and overnight overdrafts in connection with the settlement of customer security transactions.

In addition to these services, the agency offices will provide settlement and safekeeping of securities certificates for U.S. and foreign customers. In the London agency office, the securities to be held will typically be United Kingdom equity securities that are registered instruments under the name "████████████████████" (a U.K. legal entity), with designation numbers provided for each customer who owns the underlying securities.

The Association has represented that customer funds will at times be delivered to the agency offices pending the purchase of securities on behalf of the customer. At other times, customer securities will be sold and the agency offices will receive the proceeds of sale pending the receipt of further customer instructions. The agency offices will deposit all such funds in an affiliate bank or some other correspondent bank with which the Association will establish a subcustodian agreement. A single custodian account will be established at each of these banks in the name of the Association's New York branch office. Funds will be withdrawn from the accounts at the custodian banks as necessary. No funds will be held in a deposit or similar account at the agency offices.

## 2. Securities Lending Activities

The Association expects that the proposed agency offices will assist the Association in arranging "securities lending" transactions for domestic or foreign representatives of U.S.-based borrowing entities. The Association defines "securities lending" as the loan of securities by an owner, directly or through an agent, to a borrower on a fully secured basis. Under the terms of a typical securities lending transaction, the Association will act as an agent for its customers, and will effect the loan of the owner's securities to the borrower on behalf of the owner. In these transactions, the Association will act only as an agent for its customers and will not act as a principal. Accordingly, the securities lending transactions will be recorded in the [REDACTED] branch office of the Association as a securities lending transaction between the owner and the borrower. These transactions will be conducted in a manner consistent with customer instructions.

The securities on "loan" will typically include U.S. and foreign securities, and will be collateralized by U.S. dollars, letters of credit or U.S. government securities. The customer will be instructed to deposit any cash that might be used to collateralize these transactions directly with the home office of [REDACTED], an affiliated U.S. bank, in [REDACTED]. The agency offices will assist with related recordkeeping and reporting services, which will be maintained at [REDACTED] in [REDACTED].

## 3. Paying Agency Services

The Association, with the assistance of its agency offices, also intends to render a variety of paying agency services for third party customers that issue bonds, debentures or other debt instruments to private or public investors. The Association will be appointed as the fiscal, issuance or paying agent (or any combination thereof) for the debt issuance. In these transactions, the Association will not act as principal, and the debt instruments being issued will not be reflected on the Association's balance sheet. As fiscal agent, issuing agent or paying agent, the Association, with the assistance of the agency offices, will provide one or more of the following services: 1) safekeeping of bank notes and certificates in vaults; 2) physical issuance of the debt instruments, upon the instructions of the customer;<sup>1</sup> 3) publication of appropriate notices relating to the debt issuance in the financial press; 4) calculation of interest rates on the debt

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<sup>1</sup> If these transactions result in the receipt of cash by the agency office, that cash will be deposited at the home office of [REDACTED] in [REDACTED].

issuance; 5) services in connection with the redemption of bonds, debentures or other debt instruments on, or prior to, maturity; 6) arranging for the payment of interest on due dates; and 7) monitoring the receipt of funds from the issuer and payments to the holders of the debt instruments.

#### 4. CEDEL Depository Services

The Association's London agency office will also act as custodian of CEDEL certificates, holding them in the agency office's vault. CEDEL is a depository organization located in Europe that allows its members to effect transfers of securities in book entry form. CEDEL will immobilize the underlying securities by delivering the Eurobond bearer certificates to the Association's agency office in London.

The agency office will provide a variety of services with respect to these certificates including the authentication, counting and deposit of certificates, and the clipping of coupons and the presentation of those coupons to the fiscal/paying agent for payment. When certificates are presented to the fiscal/paying agent, payment is made directly to CEDEL as the registered owner of the certificates.

#### B. Organization And Supervision Of The Proposed Agency Offices

The Association has represented that the activities of the two proposed agency offices, which will be restricted to those services described above, will assist the Association in conducting its U.S.-based institutional trust business. As part of the transfer of the Bank's trust business to the Association, institutional trust customer relationships previously established by [REDACTED] subsidiaries located in the United States will be transferred to the Association branch offices in the United States, and will be maintained through those offices. The overseas agency offices will be established solely for the purpose of providing services in support of those U.S.-oriented customer relationships. The overseas offices will not engage in any lending in the United Kingdom or Australia beyond what is described above, and will not offer deposit accounts or otherwise act as branches or stand-alone operations.

The employees of the agency offices will report directly to the officers of the Association located in the Association's branch offices in [REDACTED] and [REDACTED]. The agency offices will be linked by computer to the Association's branch offices in [REDACTED] and [REDACTED], which will enable officers in the two branch offices to monitor, supervise and control the activities of the two agency offices. The agency offices will maintain records

of all business that they transact, and will transmit copies of such records to branch offices of the Association.

The Association has represented that both agency offices will be fully open at all times to OTS examiners or their designees. In addition, because of the computer linkups between the agency offices and the branch offices of the Association in [REDACTED] and [REDACTED], all of the records of the agency offices can be accessed by OTS examiners who visit the [REDACTED] and [REDACTED] branch offices.

It is presently anticipated that the London agency office will comprise [REDACTED] square feet and will consist of [REDACTED] officers and [REDACTED] additional full time employees. The facility will not generally be open to the public other than for delivery or pick up of securities, collateral, and so forth. It is anticipated that the Sydney agency office will comprise [REDACTED] square feet and will consist of [REDACTED] officers and [REDACTED] additional full time employees. The Sydney office also will generally not be open to the public other than for the delivery or pickup of securities, collateral, and so forth. Virtually all of the employees in both offices will consist of persons who are currently performing similar functions in the Bank's London and Sydney branches.

### III. Discussion

Section § 5(a) of the Home Owners' Loan Act (the "HOLA") authorizes the Director of the OTS to provide for the organization, incorporation, examination, operation, and regulation of federal savings associations. The courts have recognized that this is an exceptionally broad delegation of power that gives the OTS wide regulatory discretion,<sup>2</sup> including discretion to determine the permissible location of branches and other offices of federal savings associations.<sup>3</sup>

Pursuant to this broad grant of authority, the OTS has promulgated 12 C.F.R. § 545.96, which permits the organization of an agency office, without OTS approval, for the purpose of servicing and originating (but not approving) loans and managing or

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<sup>2</sup> See Fidelity Federal Sav. & Loan Ass'n v. de la Cuesta, 458 U.S. 141, 160-167 (1982).

<sup>3</sup> See, e.g., Fayetteville Sav. and Loan Ass'n v. FHLBB, 570 F.2d 693, 710 (8th Cir. 1978); Central Sav. and Loan Ass'n of Chariton, Iowa v. FHLBB, 422 F.2d 504, 507 (8th Cir. 1970); Independent Bankers Ass'n of America v. FHLBB, 557 F. Supp. 23 (D.D.C. 1982).

selling repossessed real estate.<sup>4</sup> The regulation further provides that, with the exception of making payments on savings accounts (which would be tantamount to the establishment of a branch), the OTS may authorize the offering of any additional services through an agency office that could be offered from a branch of a federal savings association,<sup>5</sup> including the types of trust services proposed by the Association.<sup>6</sup> The regulation imposes no limitations on the geographic location of agency offices. Thus, the Association's proposal to establish foreign agency offices to provide clearinghouse services for the Association's domestic trust operations is permissible under the plain language of the OTS's agency office regulation.

The Association's proposal also appears to be consistent with the policies underlying the agency office regulation. Prior to 1989, the agency office regulation contained express geographic restrictions. Federal savings associations were prohibited from establishing agency offices outside the states where they had their home or branch offices.<sup>7</sup> In 1989 the regulation was amended to eliminate this prohibition.

The preamble to this amendment explains that one of the key reasons for removing geographic limits from the regulation was to promote competitive parity between thrifts and national banks. Notably, national banks have long been permitted to establish foreign operations, including full service foreign branches, subject to Federal Reserve Board approval.<sup>8</sup> Indeed, the precise services that the Association proposes to offer through its agency office have been heretofore offered by a foreign branch of the Association's affiliated bank. These services are also routinely offered by other banks that have trust departments. If the Association were unable to provide these same services after the Bank's trust business is transferred to the Association, the Association would be placed at a competitive disadvantage.

Finally, it is a well settled principle of interpretation that those who are charged with interpreting a statute or regulation

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<sup>4</sup> 12 C.F.R. § 545.96(a) (1994).

<sup>5</sup> 12 C.F.R. § 545.96(b) (1994).

<sup>6</sup> See 12 C.F.R. Part 550 (authorizing federal thrifts to offer trust services directly with OTS approval).

<sup>7</sup> See 54 Fed. Reg. 50613 (Dec. 8, 1989).

<sup>8</sup> See, e.g., § 25 of the Federal Reserve Act, 12 U.S.C.A § 601 (West 1990 and Supp. 1994); 12 C.F.R. § 211.5(b)(2)(iii).

should not presume to graft new requirements or restrictions on to the plain language of the statute or regulation unless there is compelling evidence that this is what the promulgating authority intended.<sup>9</sup> A review of the history of the agency office regulation has turned up no compelling evidence that the OTS or its predecessor, the Federal Home Loan Bank Board ("FHLBB"), intended to prohibit foreign agency offices. In fact, as the foregoing discussion indicates, the history of the regulation provides affirmative support for authorization of foreign agency offices. Although the preamble to the regulation makes clear that the immediate impetus for eliminating geographic restrictions was a desire to permit "nationwide" agency office networks, there is no indication that either the OTS or the FHLBB intended this to be the full permissible extent of agency office location.<sup>10</sup> Had this been the intent, it seems likely that the state-based geographic restrictions would have been replaced with a U.S.-based restriction. Instead, the regulation was amended to eliminate geographic restrictions altogether.

Accordingly, we conclude that the Association's proposal to establish agency offices in London and Sydney may lawfully be approved by the OTS under 12 C.F.R. § 545.96.

The OTS is not required to approve the Association's proposal, however. Although the regulation does not articulate specific review standards, the OTS is required by statute to exercise its regulatory discretion in a manner that promotes safety and soundness.<sup>11</sup> Thus, the OTS may disapprove any foreign agency office that is deemed to present undue risk,<sup>12</sup> or it may impose conditions designed to ensure safety and soundness in connection with any approval. We defer to Washington Operations and the West

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<sup>9</sup> 1A and 2A Sutherland, Statutory Construction, §§ 31.06 and 47.37 (5th Ed.).

<sup>10</sup> The proposal to eliminate the geographic restrictions was issued by the FHLBB. 54 Fed. Reg. 30555 (July 21, 1989). Soon thereafter the FHLBB was replaced by the OTS, and the OTS issued the final rule eliminating the geographic restrictions. 54 Fed. Reg. 50613 (December 8, 1989).

<sup>11</sup> E.g., 12 U.S.C.A. § 1463(a) (West Supp. 1994).

<sup>12</sup> Because of special risks that can sometimes be presented by foreign operations (see discussion below), no foreign agency office may be established on a preapproved basis, even where the activities of that office will be limited to customary preapproved agency office activities. An application will always be required to establish a foreign agency office.

Region to determine whether the Association's application adequately addresses the relevant risks and whether the application should ultimately be approved, disapproved, or conditionally approved.

We recommend, however, that when reviewing applications to establish foreign agency offices, consideration be given to whether certain unique risks that can be presented by foreign operations have been adequately addressed in the institution's application. The types of risks that should be considered include:

- The risk of instability in the economy, currency, or political system of the proposed host country.
- The risk that the institution in question will not be sufficiently familiar with the markets, laws, culture, and political system of the host country to operate effectively and avoid problems.
- The risk that the remoteness of the location will result in insufficient oversight and monitoring by management of the institution.
- The risk that the OTS will not have full access to the agency office and full enforcement jurisdiction.

We have attached to this opinion as Appendix A examples of the types of conditions that may be appropriate to address the foregoing risks. These sample conditions were developed in connection with the Policy Review Committee's consideration of the permissibility of foreign agency offices and foreign operating subsidiaries. Because the facts of each proposal to conduct foreign operations will differ, however, appropriate conditions may also differ from case to case. We defer to Washington Operations and the West Region to determine what conditions are appropriate in the present case.

In reaching the conclusions set forth in this memorandum, we have relied upon the representations contained in the Association's application, as summarized herein. Our conclusions depend upon the accuracy and completeness of those representations. Any material change in circumstances from those described herein might require different conclusions.

If you have any questions regarding this memorandum, please feel free to contact Laurie Nicoli, Counsel (Banking and Finance), at (202) 906-7452.



Appendix A

Foreign Operations: Sample Conditions of Approval

- 1) The type and scope of proposed activities for the foreign office cannot be modified or expanded without OTS approval, and the country location cannot be changed. (Additionally, the thrift's initial aggregate investment could be limited to a certain predetermined amount).
- 2) The thrift shall establish and document internal controls that demonstrate adequate oversight of the foreign office.
- 3) The thrift and its foreign office shall make available to the OTS such information as the OTS deems necessary from time to time to monitor the activities of the foreign office and the effect of its activities on the safe and sound operation of the thrift. In this regard, the thrift shall maintain a duplicate set of records of the foreign office in the U.S. in a location accessible to OTS examiners.
- 4) The thrift shall submit a reasoned opinion of counsel in a form acceptable to the OTS indicating that there are no laws of the foreign jurisdiction that would restrict OTS access or enforcement authority with respect to the foreign office or its institution-affiliated parties.
- 5) The thrift and each institution-affiliated party associated with the foreign office shall consent in writing to the jurisdiction of the U.S. over, and the applicability of U.S. law to, the foreign office and its institution-affiliated parties for purposes of all claims made by, proceedings initiated by, or obligations to, the U.S., the OTS and any U.S. governmental agency, department or division, and shall consent in writing to the jurisdiction of the OTS over the foreign office and its institution-affiliated parties for purposes of examination, supervision and enforcement.
- 6) The thrift shall consent in writing to the disclosure by foreign governmental authorities to the OTS of information on the operations of the foreign office that the OTS deems necessary to determine and enforce compliance with applicable federal law.
- 7) The thrift shall agree in writing to terminate operations of the foreign office if the OTS, in its sole discretion, determines that such operations present undue risk.