Office of Thrift Supervision
Department of the Treasury
1700 G Street, N.W., Washington, D.C. 20552 • (202) 906-6000

December 30, 1994

[redacted]

Re: Interaffiliate Banking Arrangements

Dear [redacted]

This responds to your inquiry, submitted on behalf of a group of affiliated federal savings associations controlled by [redacted] (the "Holding Company"), regarding whether the affiliated associations may begin offering certain basic banking services (i.e., deposits, withdrawals, check cashing, and loan payments) to each other's customers without being deemed to become branches of one another.

For the reasons set forth below, we conclude that the associations may provide the services you have specified to each other's customers without filing branch applications. When providing these services, however, the associations must take various safety and soundness precautions described below.

Background

[redacted], is a wholly-owned first-tier subsidiary of the Holding Company. Virtually all of [redacted] branches are located in Minnesota. In 1993, [redacted] acquired two wholly-owned first-tier federal savings association subsidiaries, which were renamed [redacted] and [redacted] has most of its branches in and around [redacted] has most of its branches in and around [redacted].

Because of the proximity between Milwaukee and Chicago, there is considerable demand by customers of [redacted] to transact business at the branches of [redacted], and vice versa. There is also demand for customers of [redacted] to transact business at the branches of [redacted] and [redacted], and vice versa.

In the arrangement you propose, each of the three associations would offer certain basic banking services to customers of the other associations. These services would be limited to accepting deposits and loan payments, cashing checks, and making payments on withdrawals. In accordance with Regulation CC,[1] deposits would be credited to customers' accounts as of the time received by the service-providing association. Loan payments would not be credited to customers' accounts until actually received by the lending association. However, customers would be notified of the delayed credit for loan payments at the time such payments are accepted by the service-providing association.

Last year, you sought a legal opinion from the Office of Thrift Supervision ("OTS") regarding whether federal savings associations may enter into arrangements such as the foregoing (hereafter, "interaffiliate banking arrangements") and, if so, whether branching applications are required. By letter dated December 6, 1993, we advised you that OTS had addressed this issue previously, and attached OTS Op. Chief Counsel, October 10, 1992. That opinion concluded that federal savings associations are authorized to enter into interaffiliate banking arrangements,[2] but must first obtain branching approval. However, the opinion made clear that the requirement for branching approval was adopted as a provisional measure to allow the OTS to identify and assess any supervisory issues that may arise in interaffiliate banking arrangements. The opinion noted that the branch application requirement might eventually be eliminated to allow greater parity with national banks and state banks.

Just two days prior to release of the OTS opinion, the Office of the Comptroller of the Currency ("OCC") had issued an opinion concluding that national banks may obtain deposit, withdrawal, and loan payment services for their customers from affiliated national banks without being deemed to establish new branches.[3] In reaching this conclusion, the OCC noted, inter alia, that the McFadden Act,

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[1] 12 C.F.R. § 229.19 (1994).

[2] The statutory authority of federal savings associations to accept deposits, make loans, and provide other basic banking services, 12 U.S.C.A. § 1464(a) - (c) (West Supp. 1994), necessarily includes within it the power to contract with others to assist in providing those services -- subject, of course, to principles of safety and soundness. Thus, for example, federal savings associations have long been permitted to obtain correspondent services from other depository institutions. Cf. United States v. Citizens & Southern National Bank, 422 U.S. 86, 114 (1975) (providing an overview of the history of correspondent services in banking).

[3] OCC Interpretive Letter No. 610, October 8, 1992.

which governs branching by national banks, defines a "branch" as any office "established and operated" by a national bank "at which deposits are received, or checks paid, or money lent."[4] The OCC observed that prior judicial decisions had concluded that national banks are deemed to "establish" new branches when they purchase or rent automated teller machines ("ATMs"), but not when they merely enter into an agreement to gain access to an ATM network owned and operated by another company.[5] The OCC concluded that interaffiliate banking arrangements are analogous to agreements to gain access to ATM networks owned and operated by others, since the offices from which new banking services are offered to the customers of a national bank that enters into an interaffiliate banking arrangement are not established and operated by that national bank.[6]

This conclusion was ratified by Congress in the Riegle-Neal Interstate Banking and Branching Efficiency Act ("Act"),[7] which was signed into law on September 29, 1994. Section 101(d) of that Act provides that any bank subsidiary of a bank holding company may receive deposits, renew time deposits, close loans, service loans, and receive loan payments as an agent for a depository institution affiliate, and that the agent bank in such cases will not be considered a branch of the affiliate. The Conference Report accompanying the Act indicates that the term "receive deposits" means the taking of deposits to be credited to an existing account and is not meant to include the opening or origination of new deposit accounts at an affiliated institution by the agent bank. The Conference Report also states that the permission to "close loans" is intended to authorize the performance of ministerial

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[4] 12 U.S.C.A. § 36(c) and (f) (West 1989).

[5] Independent Bankers Association of New York State v. Marine Midland Bank, N.A., 757 F.2d 453 (2d Cir. 1985), cert. denied, 476 U.S. 1186 (1986); and Independent Bankers Association of America v. Smith, 534 F.2d 921 (D.C. Cir. 1976), cert. denied, 429 U.S. 862 (1976).

[6] Recently, the OCC proposed to revise its rules governing corporate applications and notices. The proposal, inter alia, revises the definition of "branch" to reflect case law by incorporating the concept that a facility, to be considered a branch, must be "established" by a national bank. Specifically, the regulation provides that an ATM, or other unstaffed facility, that is "not owned or rented" by the bank is not "established" by the bank and, thus, is not a branch of the bank. The proposal indicates that the OCC will continue to consider what constitutes "establishment" in other contexts on a case-by-case basis. 59 Fed. Reg. 61034 (November 29, 1994).

[7] Pub. L. No. 103-328 (1994).

functions, but not the making of credit decisions or disbursement of loan proceeds. Appropriate ministerial functions include such activities as providing loan applications, assembling documents, providing a location for returning documents necessary for making the loan, providing loan account information (such as outstanding loan balances), and receiving payments.

We note that § 101(d) does not contain express permission for banks to cash checks and make payments on withdrawals on behalf of their affiliates. However, § 101(d) contains a provision expressly confirming that § 101(d) was not intended to preclude banks (or any other depository institution) from providing agency services not encompassed by § 101(d) when otherwise authorized by law or to suggest that such other services should be deemed to result in the establishment of branches.[8] Accordingly, since enactment of § 101(d), the OCC has continued to allow national banks to cash checks and make payments on withdrawals on behalf of their affiliates without obtaining branching approval.

Discussion

The Home Owners' Loan Act ("HOLA") authorizes the OTS to "provide for the organization, incorporation, examination, operation, and regulation of . . . federal savings associations . . . , giving primary consideration to the best practices of thrift institutions in the United States."[9] Numerous courts have recognized that this broad grant of regulatory authority includes the power to define, authorize, and regulate branching in whatever manner the OTS believes furthers the "best practices of thrift institutions in the United States,"[10] subject only to certain narrow statutory restrictions not relevant to the present discussion.[11] Thus, for federal savings associations, questions

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[8] See § 101(d)(4) of the Act.

[9] 12 U.S.C.A. § 1464(a) (West Supp. 1994).

[10] E.g., City Federal Savings & Loan Association v. Federal Home Loan Bank Board, 600 F.2d 681 (7th Cir. 1979); Bridgeport Federal Savings & Loan Association v. Federal Home Loan Bank Board, 307 F.2d 580 (3rd Cir. 1962), cert. denied, 371 U.S. 950 (1963); and Bloomfield Federal Savings & Loan Association v. American Community Stores Corp., 396 F. Supp. 384 (D. Neb. 1975).

[11] The only statutory provisions that have a direct impact on OTS's regulatory discretion with respect to branching are: (i) HOLA § 5(r), 12 U.S.C.A. § 1464(r) (West Supp. 1994), which requires institutions that branch interstate (as well as their interstate branches) to meet the tax code definition of a "domestic building and loan association;" (ii) HOLA § 10(e)(3), 12 U.S.C.A.

regarding branching are governed primarily by OTS regulations, rather than by statute.

Section 545.92 of OTS's regulations requires federal savings associations to obtain advance OTS approval before establishing branch offices. For these purposes, the term "branch office" is defined as "any office [of a federal savings association] other than its home office, agency office, data processing or administrative office, or a remote service unit."[12] Thus, the OTS's regulatory definition of a branch is different from, and somewhat narrower than, the McFadden Act definition. For example, under the OTS definition, ATMs (which are classified as remote service units) are not deemed to be branches even when owned and operated directly by a federal savings association.[13] In addition, federal savings associations are permitted to establish offices that lend money (which are classified as agency offices) without obtaining branch approval.[14]

Notwithstanding these differences, the OTS regulatory definition of branch does share at least one important characteristic with the McFadden Act definition -- both contain an "establishment" concept. Although the OTS definition does not explicitly use the term "establish," this concept is nevertheless implicit in the definition. The full text of the definition reads as follows:

> A branch office of a federal savings association is any office other than its home office, agency office, data processing or administrative office, or a remote service unit.

Thus, a facility from which customer services are provided constitutes a branch within the meaning of the OTS definition only if: (a) the facility is not a home office, agency office, data processing office, administrative office, or remote service unit;

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§ 1467a(e)(3) (West Supp. 1994), which prohibits interstate branching by savings association subsidiaries of multiple savings and loan holding companies, except under certain defined circumstances; and (iii) the Community Reinvestment Act ("CRA"), 12 U.S.C.A. §§ 2902(3)(C) and 2903(2) (West 1989), which requires OTS to consider an institution's CRA rating when considering a branch application.

[12] 12 C.F.R. § 545.92(a).

[13] 12 C.F.R. §§ 545.92(a) and 545.141(a)(3).

[14] However, agency office approval -- which is a less exacting process -- is required under certain circumstances. 12 C.F.R. §§ 545.92(a) and 545.96.

and (b) the facility is an "office of [the] federal savings association." In this context, the preposition "of" is "used as a function word to indicate belonging or a possessive relationship."[15] In other words, a facility must be "established and operated" by a federal savings association before it will be deemed a branch of that association.[16] Thus, when a federal savings association contracts with an affiliate to obtain banking services for its customers out of offices owned and operated by the affiliate, the contracting association does not establish a new branch office within the meaning of OTS regulations.

This conclusion is reinforced by several additional considerations. First, there is no difference between the services that will be provided to customers via interaffiliate banking arrangements (as defined herein) and the services that can already be provided to those customers via ATM machines located in the retail offices of affiliates (or elsewhere).[17] Since no branch application is required when services are provided through an ATM located in the office of an affiliate (or elsewhere), it follows that no application should be required when the same services are instead provided by a teller employed by the affiliate. Second, the OTS and its predecessor have long sought to regulate branching and related activities in a manner that "provides flexibility for federal associations to better serve their communities in innovative ways."[18] Permitting interaffiliate banking arrangements

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[15] Webster's New Collegiate Dictionary 819 (9th ed. 1986).

[16] See OTS Op. Acting Chief Counsel, June 13, 1994 (concluding that the offices of a broker/dealer affiliate of a federal savings association will not become branches of the association if the broker/dealer solicits trust business for the association); and OTS Op. by Comizio, Nov. 20, 1992 (concluding that a student-operated banking facility at a school that collects deposits and forwards them to a federal savings association is not a branch of the association).

[17] See OTS Op. Chief Counsel, Dec. 19, 1994 (concluding that a federal savings association may place advanced ATMs in the offices of a broker/dealer affiliate without filing a branch application, subject to certain restrictions; the advanced ATMs include video phone access to association personnel, printers that print out loan and deposit applications, and a day depository drawer for receipt of loan and deposit applications).

[18] 45 Fed. Reg. 31046 (May 12, 1980) (this statement was made at the time the regulatory definition of "branch office" was first promulgated). See also, OTS Op. by Comizio, May 16, 1994, and FHLBB Op. by Quillian, Nov. 20, 1986 (both reiterating the longstanding policy of the OTS and its predecessor to regulate branching and related issues in a manner that enhances customer

without requiring branch applications will further these longstanding policy objectives. Third, as noted above, national banks are authorized to enter into interaffiliate banking arrangements without obtaining branching approval. A number of states have also recently enacted statutes expressly authorizing state institutions to enter into interaffiliate banking arrangements without obtaining branching approval.[19] Thus, permitting federal savings associations to enter into interaffiliate banking arrangements without requiring branch applications will enhance competitive parity.

Accordingly, we conclude that federal savings associations may enter into interaffiliate banking arrangements without filing branching applications. When entering into these relationships, however, savings associations must address various safety and soundness and supervisory issues identified in our 1992 opinion. For example, affiliated savings associations must establish procedures that will maintain their separate corporate identities and avoid customer confusion. Simple indicators such as transaction receipts that have been printed with the name of the institution providing the service can help avoid such confusion. Clear disclosure should also be given to customers regarding any delay in crediting loan payments.

In addition, the need to ensure integrity of assets and records is especially strong in the interaffiliate banking context. As noted in the OCC's opinion:

> In accordance with principles of safety and soundness, the [service-providing institution] and the [account-holding institution should] clarify among themselves who bears the risk of loss with respect to items while in transit, the legal relationship between themselves, and when accounts will be credited with deposits and charged for withdrawals. In addition, [institutions] participating in such arrangements [should] establish appropriate procedures for identifying, segregating and properly recording items received by the [service-providing institution] on behalf of the [account-holding institution], establish appropriate procedures for identifying customers seeking withdrawals and verifying such transactions, and establish appropriate withdrawal limitations. The [service-providing institution] and the [account-holding institution] also [should] develop policies with respect to recordkeeping, reporting and disclosures to customers to assure that all legal and

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service and fosters healthy competition).

[19] E.g., Ill. Ann. Stat. ch. 17, para. 311, § 5 (Smith-Hurd 1994). This law took effect on July 1, 1992.

prudential requirements, including any relevant laws regarding financial privacy, to which each institution is subject, [will] be satisfied.

The OTS will require savings associations to follow these same procedures when they enter into interaffiliate banking arrangements.

In reaching the foregoing conclusions, we have relied on the factual representations contained in the materials you submitted to us, as summarized herein. Our conclusions depend upon the accuracy and completeness of those representations. Any material change in circumstances from those described herein could result in different conclusions.

If you have any questions regarding this letter, please feel free to contact Richard C. Blanks, Counsel (Banking and Finance), at (202) 906-7037.

Sincerely,

Carolyn B. Lieberman
Chief Counsel

cc: All Regional Directors
All Regional Counsel