

BOARD OF GOVERNORS
of the
FEDERAL RESERVE SYSTEM

STATEMENT FOR STATE MEMBER BANKS

ON THE

"BANK SERVICE CORPORATION ACT"

(Public Law 87-856, approved October 23, 1962)

Issued October 23, 1962

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Purpose of the Statement. - The purpose of this statement is to provide some initial guidance to State banks that are members of the Federal Reserve System relative to the so-called "Bank Service Corporation Act," which became effective on the approval date shown on the cover page hereof. A copy of the text of the Act is attached to this statement.

The Act involves an area of relatively recent development and is the first Federal legislation to deal with the subject specifically. None of the provisions of the Act has a delayed effective date. While all banks are not expected to have the same immediate interest therein, the Act or some of its provisions will have a present interest to many banks which contemplate or now have arrangements for utilizing bank services of the kind covered by the Act. Accordingly, this statement sets forth or summarizes salient features of the Act and refers in some detail to the provisions of section 5 of the Act relating specifically to the assurances concerning regulation and examination required to be furnished to the appropriate Federal supervisory agency which, in the case of State member banks, is the Board of Governors of the Federal Reserve System.

Bank investment in bank service corporations. - The legislative history of the Act contains numerous recognitions of the need to enable banks to utilize modern automated equipment by means of their ownership of stock in corporations referred to in the Act as "bank service corporations."

To facilitate this objective, the Act provides that "No limitation or prohibition otherwise imposed by any provision of Federal law exclusively relating to banks shall prevent any two or more banks from investing not more than 10 per centum of the paid-in and unimpaired capital and unimpaired surplus of each of them in a bank service corporation." This 10 per cent investment ceiling applies to loans and other advances of funds, as well as the purchase of stock.

The Act, however, does not authorize a State bank to invest in a bank service corporation if the bank is not permitted to do so under applicable State law.

Bank service corporations. - "Bank service corporation" is defined in the Act to mean "a corporation organized to perform bank services for two or more banks, each of which owns part of the capital stock of such corporation, and at least one of which is subject to examination by a Federal supervisory agency."

While initially at least two or more banks must own stock in a bank service corporation, the Act provides that if one bank ceases to hold such stock and to utilize the services of the corporation, the remaining bank may continue to hold stock of and be serviced by the corporation.

Bank service corporations are prohibited from performing any services for persons or organizations other than banks. Another provision of the Act is intended to prevent any unfair or anti-competitive use of a bank service corporation to the disadvantage of a non-stockholding bank applying for service from the corporation.

Examination and regulation. - Under section 5 of the Act, no State member bank "may cause to be performed, by contract or otherwise, any bank services for itself, whether on or off its premises, unless assurances satisfactory to" the Board of Governors of the Federal Reserve System are furnished to it "by both the bank and the party performing such services that the performance thereof will be subject to regulation and examination by" the Board of Governors "to the same extent as if such services were being performed by the bank itself on its own premises." (Section 5 of the Act also applies to national banks and nonmember insured banks; but, as to them, the assurances described in the section must be furnished to the Comptroller of the Currency or the Federal Deposit Insurance Corporation, as the case may be.)

With respect to section 5 of the Act, the Senate Committee on Banking and Currency stated that the Federal supervisory agencies "must be able to examine all of the banks' records, and they must be able to exercise proper supervision over all the banks' activities, whether performed by the banks' employees on their premises or by anyone else on or off the banks' premises. This examination and this supervision cannot be frustrated by a transfer of the banks' records to some other organization or by having some other organization carry out all or part of the banks' functions." (S. Rept. No. 2105, 87th Cong. on H. R. 8874, Sept. 18, 1962, p.3.) Similarly, the Committee on Banking and Currency of the House of Representatives stated that "it would obviously be unwise to permit banks to avoid the examination and supervision of vital banking functions by the simple expedient of farming out such functions." (H. Rept. No. 2062, 87th Cong. on H. R. 8874, July 30, 1962, p. 2.)

Assurances of banks and suppliers of bank services. - The assurances required by section 5 of the Act in the case of a State member bank should be furnished to the Board of Governors through the Federal Reserve Bank of the district. The Act requires such assurances from the party or organization performing the bank services, as well as from the bank for which the services are performed. Assurances are required whether the services are performed under pre-existing arrangements or new arrangements, and whether the services are performed by bank service corporations or others.

Unless and until further experience with the new legislation should indicate a need for other or more detailed procedures, it will be satisfactory for the required assurances to be furnished to the Board of Governors by a letter addressed by the State member bank to the Federal Reserve Bank, stating in substance that the bank and the servicing agency have agreed that the performance of the services will be subject to regulation and examination by the Board of Governors to the same extent as if the services were being performed by the bank

itself on its own premises. With respect to any service arrangement in existence at the effective date of the Act, it is expected that the letter of assurance will be received by the Federal Reserve Bank as promptly as practicable, preferably within 30 days from such date. As to any service arrangement entered into or renewed after the effective date of the Act, the letter of assurance should be received by the Federal Reserve Bank prior to the performance of any services under such arrangement. Such letters need not be furnished, unless specifically requested by the Board of Governors, in connection with arrangements for the performance of legal services or administrative services such as transportation services or guard services. Arrangements for bank services needed because of emergencies or short periods of unusually heavy work may also be made without furnishing such letters where it would be impracticable to do so.

"Bank services." - In connection with section 5 of the Act, as well as in other connections, references are made in the Act to "bank services." That term is defined in the Act to mean "services such as check and deposit sorting and posting, computation and posting of interest and other credits and charges, preparation and mailing of checks, statements, notices, and similar items, or any other clerical, bookkeeping, accounting, statistical, or similar functions performed for a bank."

As previously noted, numerous recognitions appear in the Act's legislative history of the need for banks and their customers to benefit from the use of modern automated equipment. Of further relevance with respect to the meaning of "bank services" are the statements quoted above from the reports of the congressional committees. Bearing importantly upon the meaning of "bank services" also is the following further quotation from page 3 of the Report of the Senate Committee:

"The authority to examine and supervise banks is broad and must be vigorously exercised. At the same time sound discretion must be used. Banks have always employed others to do many things for them, and they will have to continue to do so, and the bill is not intended to prevent this or to make it more difficult. For example, banks have employed lawyers to prepare trust and estate accounts and to prosecute judicial proceedings for the settlement of such accounts. Banks have employed accountants to prepare earnings statements and balance sheets. Banks have employed public relations and advertising firms. And banks have employed individuals or firms to perform all kinds of administrative activities, including armored car and other transportation services, guard services and, in many cases, other mechanical services needed to run the banks' buildings. It is not expected that the bank supervisory agencies would find it necessary to examine or regulate any of these agents or representatives of a bank, except under the most unusual circumstances. The authority is intended to be limited to banking functions as such.

"The Committee is aware also that, during emergencies and short periods of unusually heavy work, performance of bank services by outside organizations may be necessary and may involve no problems from the point of view of bank examination and supervision. The committee expects the bank supervisory agencies to make sure that the authority vested in them under the bill and their general supervisory authority are exercised with this need in mind."

Inquiries concerning the Act. - Inquiries concerning the Act as it relates to State member banks should be addressed to the Federal Reserve Bank of the district in which the inquiry arises.

Attachment

AN ACT

To authorize certain banks to invest in corporations whose purpose is to provide clerical services for them, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That for the purposes of this Act--

(a) The term "Federal supervisory agency" means the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, or the Board of Directors of the Federal Deposit Insurance Corporation.

(b) The term "bank services" means services such as check and deposit sorting and posting, computation and posting of interest and other credits and charges, preparation and mailing of checks, statements, notices, and similar items, or any other clerical, bookkeeping, accounting, statistical, or similar functions performed for a bank.

(c) The term "bank service corporation" means a corporation organized to perform bank services for two or more banks, each of which owns part of the capital stock of such corporation, and at least one of which is subject to examination by a Federal supervisory agency.

(d) The term "invest" includes any advance of funds to a bank service corporation, whether by the purchase of stock, the making of a loan, or otherwise, except a payment for rent earned, goods sold and delivered, or services rendered prior to the making of such payment.

SEC. 2. (a) No limitation or prohibition otherwise imposed by any provision of Federal law exclusively relating to banks shall prevent any two or more banks from investing not more than 10 per centum of the paid-in and unimpaired capital and unimpaired surplus of each of them in a bank service corporation.

(b) If stock in a bank service corporation has been held by two banks, and one of such banks ceases to utilize the services of the corporation and ceases to hold stock in it, and leaves the other as the sole stockholding bank, the corporation may nevertheless continue to function as such and the other bank may continue to hold stock in it.

SEC. 3. Whenever a bank (referred to in this section as an "applying bank") subject to examination by a Federal supervisory agency applies for a type of bank services for itself from a bank service corporation which supplies the same type of bank services to another bank, and the applying bank is competitive with any bank (referred to in this section as a "stockholding bank") which holds stock in such corporation, the corporation must offer to supply such services by either--

(1) issuing stock to the applying bank and furnishing bank services to it on the same basis as to the other banks holding stock in the corporation, or

(2) furnishing bank services to the applying bank at rates no higher than necessary to fairly reflect the cost of such services, including the reasonable cost of the capital provided to the corporation by its stockholders,

at the corporation's option, unless comparable services at competitive overall cost are available to the applying bank from another source, or unless the furnishing of the services sought by the applying bank would be beyond the practical capacity of the corporation. In any action or proceeding to enforce the duty imposed by this section, or for damages for the breach thereof, the burden shall be upon the bank service corporation to show such availability.

SEC. 4. No bank service corporation may engage in any activity other than the performance of bank services for banks.

SEC. 5. (a) No bank subject to examination by a Federal supervisory agency may cause to be performed, by contract or otherwise, any bank services for itself, whether on or off its premises, unless assurances satisfactory to the agency prescribed in subsection (b) of this section are furnished to such agency by both the bank and the party performing such services that the performance thereof will 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.

(b) The assurances required by subsection (a) of this section shall be given, in the case of--

(1) a national banking association or a bank operating under the code of laws for the District of Columbia, to the Comptroller of the Currency;

(2) a bank (other than a bank described in paragraph (1)) which is a member of the Federal Reserve System, to the Board of Governors of the Federal Reserve System; and

(3) a bank (other than a bank described in paragraph (1) or (2)) whose deposits are insured by the Federal Deposit Insurance Corporation, to the Board of Directors of the Federal Deposit Insurance Corporation.