FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 6201]
[August 14, 1968]

Interpretation by Board of Governors

To the State Member Banks in the Second Federal Reserve District:

The following statement was made public today by the Board of Governors of the Federal Reserve System:

In interpretations of Federal banking laws issued today, the Board of Governors of the Federal Reserve System decided that:

1. State banks that are members of the Federal Reserve System, as well as national banks, may purchase for their own account shares of corporations to perform, at locations at which the banks are authorized to engage in business, functions that the banks are empowered to perform directly.

2. State banks that are members of the Federal Reserve System, as well as national banks, may establish and operate, at any location in the United States, "loan production offices" that perform only servicing activities of the type described in the interpretation. Such offices may be established and operated by banks either directly, or indirectly through wholly-owned subsidiary corporations.

The interpretations, determined following a reexamination of Federal statutes, reversed positions taken by the Board in 1966 and 1967. All members of the Board concurred in the new rulings except Governors Robertson and Brimmer, who adhered to the prior interpretations.

STATEMENT BY GOVERNORS ROBERTSON AND BRIMMER

Governors Robertson and Brimmer, in stating the reasons for their dissent, said:

We are of the view that insofar as Federal laws are concerned there should be no competitive inequality as between State banks and national banks.

From the standpoint of Federal banking policy, we believe that it would be in the public interest to amend the governing statutes to give national banks and member State banks greater latitude to conduct some of their activities through subsidiary corporations.

However, the law being what it is, and the obligation of the Federal Reserve being to administer that law (with respect to State member banks) as it is — not as we might like to have it — we believe the problem should have been resolved through legislation rather than by changing our interpretation of the law.

To go even further, as the Board has done, and adopt the position that State member banks may (through these subsidiaries) establish loan production offices anywhere in the U. S., is to take such a long step toward a fundamental change in our banking structure as to call for legislative consideration — even if its legality were unquestionable, which is not the case.

Congress, rather than bank supervisors, should decide whether nationwide systems of loan production offices are to be permitted in the U. S. — whether directly through specifically approved branches or indirectly through offices of "operations subsidiaries" (where no supervisory approval would be required under this ruling). There is a provision requiring that loans must be approved and funds disbursed solely at the bank's main office or branch, but this can be accomplished by telephone. The establishment throughout the country of loan production offices by the Nation's largest banks is not a possibility to be taken lightly.

Printed below is the text of the interpretation. It will be published shortly in the *Federal Register* and *Federal Reserve Bulletin* but is being sent to you now so that you may have prompt notice of its content.

ALFRED HAYES,
President.

Member Bank Purchase of Stock of Operations Subsidiaries

The Board of Governors has reexamined its position that the so-called "stock-purchase prohibition" of section 5136 of the Revised Statutes (12 U.S.C. 24), which is made applicable to member State banks by the 20th paragraph of section 9 of the Federal Reserve Act (12 U.S.C. 355), forbids the purchase by a member bank "for its own account of any shares of stock of any corporation" (the statutory language), except

(OVER)

as specifically permitted by provisions of Federal law or as comprised within the concept of "such incidental powers as shall be necessary to carry on the business of banking," referred to in the first sentence of paragraph "Seventh" of R.S. 5136.

In 1966 the Board expressed the view that said incidental powers do not permit member banks to purchase stock of "operations subsidiaries" — that is, organizations designed to serve, in effect, as separately-incorporated departments of the bank, performing, at locations at which the bank is authorized to engage in business, functions that the bank is empowered to perform directly. (See 1966 Federal Reserve Bulletin 1151.)

The Board now considers that the incidental-powers clause permits a bank to organize its operations in the manner that it believes best facilitates the performance thereof. One method of organization is through departments; another is through separate incorporation of particular operations. In other words, a wholly-owned subsidiary corporation engaged in activities that the bank itself may perform is simply a convenient alternative organizational arrangement.

Reexamination of the apparent purposes and legislative history of the stock-purchase prohibition referred to above has led the Board to conclude that such prohibition should not be interpreted to preclude a member bank from adopting such an organizational arrangement unless its use would be inconsistent with other Federal law, either statutory or judicial.

In view of the relationship between the operation of certain subsidiaries and the branch banking laws, the Board has also reexamined its rulings on what constitutes "money lent" for the purposes of section 5155 of the Revised Statutes (12 U.S.C. 36), which provides that "the term 'branch' . . . shall be held to include any branch bank, branch office, branch agency, additional office, or any branch place of business . . . at which deposits are received, or checks paid, or money lent." [1]

The Board noted its 1967 interpretation that offices that are open to the public and staffed by employees of the bank who regularly engage in soliciting borrowers, negotiating terms, and processing applications for loans (so-called "loan production offices") constitute branches. (1967 Federal Reserve Bulletin 1134.) The Board also noted that later in that year it considered the question whether a bank holding company may acquire the stock of a so-called "mortgage company" on the basis that the company would be engaged in "furnishing services to or performing services for such bank holding company or its banking subsidiaries" (the so-called "servicing exemption" of section 4(c)(1)(C) of the Bank Holding Company Act; 12 U.S.C. 1843). In concluding affirmatively, the Board stated that "the appropriate test for determining whether the company may be considered as within the servicing exemption is whether the company will perform as principal any banking activities — such as receiving deposits, paying checks, extending credit, conducting a trust department, and the like. In other words, if the mortgage company is to act merely as an adjunct to a bank for the purpose of facilitating the bank's operations, the company may appropriately be considered as within the scope of the servicing exemption." (1967 Federal Reserve Bulletin 1911.)

The Board believes that the purposes of the branch banking laws and the servicing exemption are related. Generally, what constitutes a branch does not constitute a servicing organization and, vice versa, an office that only performs servicing functions should not be considered a branch. (See 1958 Federal Reserve Bulletin 431, last paragraph.) When viewed together, the above-cited interpretations on loan production offices and mortgage companies represent a departure from this principle. In reconsidering the laws involved, the Board has concluded that a test similar to that adopted with respect to the servicing exemption under the Bank Holding Company Act is appropriate for use in determining whether or not "money is lent" at a particular place, for the purpose of the Federal branch banking laws. Accordingly, the Board considers that the following activities, individually or collectively, do not constitute the lending of money within the meaning of section 5155 of the Revised Statutes: soliciting loans on behalf of a bank (or a branch thereof), assembling credit information, making property inspections and appraisals, securing title information, preparing applications for loans (including making recommendations with respect to action thereon), soliciting investors to purchase loans from the bank, seeking to have such investors contract with the bank for the servicing of such loans, and other similar agent-type activities. When loans are approved and funds disbursed solely at the main office or a branch of the bank, an office at which only preliminary and servicing steps are taken is not a place where "money is lent." Because preliminary and servicing steps of the kinds described do not constitute the performance of significant banking functions of the type that Congress contemplated should be performed only at governmentally approved offices, such office is accordingly not a branch.

To summarize the foregoing, the Board has concluded that, insofar as Federal law is concerned, a member bank may purchase for its own account shares of a corporation to perform, at locations at which the bank is authorized to engage in business, functions that the bank is empowered to perform directly. Also, a member may establish and operate at any location in the United States a "loan production office" of the type described herein. Such offices may be established and operated by the bank either directly, or indirectly through a wholly-owned subsidiary corporation.

This interpretation supersedes both the Board's 1966 ruling on "operations subsidiaries" and its 1967 ruling on "loan production offices," referred to above.

[1] In the Board's judgment, the statutory enumeration of three specific functions that establish branch status is not meant to be exclusive but to assure that offices at which any of these functions is performed are regarded as branches by the bank regulatory authorities. In applying the statute the emphasis should be to assure that significant banking functions are made available to the public only at governmentally authorized offices.