

FEDERAL RESERVE BANK
OF NEW YORK

at cir, no. 7790
January 7, 1976

**Interests By State Member Banks in Stock
of Telecommunications Systems Corporations**

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

On August 7, 1975, this Bank requested a ruling by the Board of Governors of the Federal Reserve System on the question whether State member banks may, under paragraph Seventh of §5136 of the Revised Statutes (12 U.S.C. §24, Seventh), acquire direct interests in the Payment and Administrative Communications Corporation ("PAC") and indirect interests in its wholly owned stock subsidiary, the Payment and Telecommunication Services Corporation ("PATS"). State member banks are subject to §5136 by virtue of Section 9 of the Federal Reserve Act (12 U.S.C. 335). The Board of Governors has determined that such holdings are permissible for State member banks.

The following is quoted from the text of the Board of Governors' letter to this Bank, dated November 4, 1975:

PAC is a nonprofit membership corporation formed primarily for the purpose of providing its members with rapid and secure telecommunications systems for the organization and delivery of funds transfer messages, messages pertaining to finance, financial or securities transactions, and financial institutions and administrative and other messages. PAC's counsel states that PAC was formed as a membership corporation in order to facilitate its operations and not to evade the prohibitions of § 5136. For example, voting rights and assessments for various expenses are related to the relative usage each member makes of the service facilities made available by PAC. PATS, however, was formed as a stock corporation in view of the existence of several State qualification restrictions. PATS' bylaws indicate that it was formed for purposes identical to those of PAC. It has been stated by counsel that no investment purpose motivated the formation of PATS as PAC's wholly owned stock subsidiary.

Paragraph Seventh of § 5136 generally prohibits a State member bank from purchasing or selling securities and stock for its own account. This restriction, however, does not prevent a State member bank from possessing a membership interest in certain nonstock corporations so long as no investment is made by the bank (§ 5405 *Published Interpretations*, 12 CFR 219.104). Consequently, the creation of PAC as a membership corporation would preclude the question of State member bank participation in PAC were it not for the presence of PAC's wholly owned subsidiary, PATS. The Board believes it appropriate, from a regulatory and supervisory standpoint, to conclude that the prohibition of paragraph Seventh of § 5136 is applicable where a nonstock membership corporation possesses an interest in a stock subsidiary corporation. To conclude otherwise would result in opportunities for circumvention of the prohibitions of § 5136.

Despite the provisions of § 5136, however, State member banks may hold shares of stock under certain limited circumstances. For example, the Board has ruled previously that § 5136 does not prevent a member bank from purchasing for its own account shares of a corporation that performs functions that the bank is empowered to perform directly (§ 4215 *Published Interpretations*, 12 CFR 250.141).

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In view of the increasingly significant role played by communications networks in the banking industry, it appears that these purposes and the activities in which PAC and PATS will engage can be viewed as reasonable and appropriate means for banks to facilitate the transfer of funds. Further, it appears that the risk exposure to member banks for obligations arising from membership in PAC is nominal. Accordingly, based on the above, the Board has determined that State member banks may acquire membership interests in PAC, thereby obtaining indirect interest in PATS, without violating the prohibitions of paragraph Seventh of § 5136 of the Revised Statutes.

The subject request raises questions relating to whether the services offered by PAC and PATS are bank services within the meaning of the Bank Service Corporation Act (12 U.S.C. 1861 *et seq.*). At this juncture, it is unclear whether such services are bank services within the meaning of 12 U.S.C. 1861(b); however, it is believed that such a determination is unnecessary at this time.

In view of the unique relationship between PAC, PATS, and State member banks, the Board believes it appropriate, from a bank supervisory viewpoint, to maintain familiarity with the activities of the corporations. Accordingly, we would appreciate it if, in communicating these views to PAC and PATS, you would obtain their consent to periodic examination by the Federal Reserve System.

PAC and PATS have both consented to periodic examination by the Federal Reserve System as requested by the Board in the last paragraph of the letter.

Any questions you may have regarding this matter may be directed to our Bank Regulations Department (Telephone No. 212-791-5922).

PAUL A. VOLCKER,
President.