

FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 8542]
March 26, 1979]

BANK SERVICE ARRANGEMENTS

— Rules Simplified

— Regulation S Revoked

*To All State Member Banks, and Others Concerned,
in the Second Federal Reserve District:*

Following is the text of a statement issued by the Board of Governors of the Federal Reserve System:

The Federal Reserve Board announced today [March 5] it is revoking one of its regulations in the ongoing program to clarify and simplify all of its regulations.

The Board decided to revoke Regulation S, which governed the Board's power to regulate and examine banking services performed for State-chartered member banks by outsiders. The regulation had been in effect since April 3, 1963, but a recent amendment to the Bank Service Corporation Act has made the regulation unnecessary.

The Board also adopted modified interpretations to simplify present interpretations and to conform them to the amended Act. The Act creates an exception to the general prohibition in Federal banking laws against the purchase of stock by member banks. The Act allows two or more banks to engage in a joint venture by investing up to 10 per cent of their capital and surplus in a "bank service corporation" that provides clerical services to banks.

Under the Regulatory Improvement Project the Board has now revoked two regulations; reviewed, updated and simplified a number of others; approved a plan for a Federal Reserve Board service to disseminate regulatory materials more widely; and expanded its rulemaking procedures to improve the quality and public understanding of its regulations.

Enclosed is the text of the Board of Governors' order in this matter. Also enclosed, for State member banks, is a statement indicating their continuing responsibility under the Bank Service Corporation Act and a suggested form of notification of performance of bank services.

Any questions on this matter should be directed to our Regulations Division (Tel. No. 212-791-5914).

PAUL A. VOLCKER,
President.

**RESPONSIBILITIES OF STATE MEMBER BANKS
UNDER THE BANK SERVICE CORPORATION ACT**

Under the Bank Service Corporation Act(12 U.S.C. 1861-65), State member banks are subject to supervision by the Board of Governors of the Federal Reserve System, and national banks are subject to supervision by the Comptroller of the Currency.

Section 5 of the Bank Service Corporation Act (but no other section) has been amended by section 308 of the Financial Institutions Regulatory and Interest Rate Control Act of 1978, effective March 10, 1979. That section, as revised, reads as follows:

Whenever any bank which is regularly examined by a Federal supervisory agency, or any subsidiary or affiliate of such bank which is subject to examination by that agency, causes to be performed, by contract or otherwise, any bank services for itself, whether on or off its premises--

(1) such performance shall be subject to regulation and examination by such agency to the same extent as if the services were being performed by the bank itself on its own premises, and

(2) the bank shall notify such agency of the existence of a service relationship within 30 days after the making of such service contract or the performance of the service, whichever occurs first.

The definition of "bank services" in section 1(b) of the Act remains the same and reads as follows:

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 other clerical, bookkeeping, accounting, statistical, or similar functions performed for a bank.

The Board has previously elaborated on this definition in two interpretations (see 12 CFR 250.301 and 250.302). In the first, the Board concluded that the term is

essentially limited to clerical and similar services and would not usually relate to legal, advisory, and administrative services, such as transportation or guard services. In the other interpretation, the Board described operations of a bank credit card service organization that would meet the definition.

The Board believes that a regulation in this area is no longer necessary and thus has rescinded Regulation S effective March 10, 1979. Existing interpretations of the Bank Service Corporation Act have been updated and streamlined to reflect the statutory change. The only substantive rulings that have been added to the interpretations are taken from: (1) an interpretation previously published only in the Federal Reserve Bulletin explaining the scope of investment authority in "bank service corporations" (48 Fed. Res. Bull. 1429 (1962)); and (2) the last sentence of section 219.4 of Regulation S, concerning the performance of legal, advisory, and administrative services.

A State member bank is to give notice when bank services are provided for it, or its affiliates or subsidiaries that are subject to Federal Reserve examination, by any servicer, including national banks; non-member insured banks; State member banks; non-profit, no-stock bank credit card service organizations, and servicing subsidiaries of bank holding companies. Notification should not be provided for the performance of legal, advisory, and administrative services, such as transportation or guard services.

For notification purposes, a letter should be signed by a duly authorized officer of the bank or of its affiliate or subsidiary for which services are performed, and be provided to the District Federal Reserve Bank. This letter is to be provided no later than 30 days after the making of a contract to provide services, or no later than 30 days after the performance of the services, whichever comes first. In lieu of a letter, the attached form may be used to report the making of a contract to provide services, or the performance of services.

If a bank has an existing bank service arrangement in effect on March 10, 1979, and has already furnished "assurances" regarding the arrangement in compliance with Regulation S, no additional notification regarding the arrangement is necessary.

In compliance with the requirements of the Bank Service Corporation Act we hereby certify that the Board of Governors of the Federal Reserve System has been notified of the bank service arrangement reported below.

LOCAL POINT OF CONTACTS WHERE SERVICES ARE PERFORMED	CORPORATE TITLE OF SERVICE
BANK'S BRANCH (AND CONTACT AT CENTRAL) (If other than handling office(s))	NAME OF SERVICE CORP'S CORPORATE MANAGER(S)
TELEPHONE NUMBER AT CENTRAL OFFICE	NAME OF HANDLING OFFICE(S) AT PROVIDING OFFICE(S)
TELEPHONE NUMBER AT PROVIDING OFFICE(S)	TELEPHONE NUMBER AT CENTRAL OFFICE
SPECIFIC SERVICES AND SERVICE PERIODS (Indicate both present and planned services)	
TELEPHONE NUMBER DATE SIGNED	TITLE OF OFFICER AUTHORIZED TO SIGN NOTIFICATION SIGNATURE OF AUTHORIZED OFFICER

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

NOTIFICATION OF PERFORMANCE OF BANK SERVICES

BANK NAME AND ADDRESS (Includes Street, City, State and ZIP Code)

Complete below (in space indicated) Federal Reserve Bank's Name and Address

In compliance with the requirement of the Bank Service Corporation Act we hereby notify the Board of Governors of the Federal Reserve System of bank services provided by the servicer reported below.

CORPORATE TITLE OF SERVICER	LOCATION(S) OF PREMISES WHERE SERVICES ARE PERFORMED
ADDRESS OF SERVICER'S CORPORATE HEADQUARTERS	
NAME OF MANAGING OFFICER(S) AT PROCESSING LOCATION(S)	BANK'S PRINCIPAL CONTACT AT CENTER(S) (If other than Managing Officer(s))
TELEPHONE NUMBER AT PROCESSING SITE	TELEPHONE NUMBER OF PRINCIPAL CONTACT(S)
APPLICATIONS PROCESSED AND SERVICES PERFORMED (Indicate both present and planned services)	

TITLE OF OFFICER AUTHORIZED TO SIGN NOTIFICATION	TELEPHONE NUMBER
SIGNATURE OF AUTHORIZED OFFICER	DATE SIGNED

Board of Governors of the Federal Reserve System
Rescission of Regulation S

[6210-01-M]

[Reg. S, Docket No. R-0209]

**PART 219—BANK SERVICE
ARRANGEMENTS**

**PART 250—MISCELLANEOUS
INTERPRETATIONS**

**Rescission of Regulation S; Amend-
ment of Interpretation Regulations**

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Revocation and amendment of interpretations.

SUMMARY: As part of its Regulatory Improvement Project, involving a substantive review of all Federal Reserve regulations, the Board has reviewed Regulation S, "Bank Service Arrangements" (12 CFR Part 219), which implements the Bank Service Corporation Act (12 U.S.C. 1861-65). That regulation specifies the manner of assuring the Board that the performance of bank services for State member banks will be subject to regulation and examination by the Board whenever the services are performed by anyone other than the bank itself. On the basis of its review and in the light of a recent amendment of the Act (Pub. L. 95-630, 92 Stat. 3677), that becomes effective on March 10, 1979, the Board has decided to: (1) Rescind Regulation S as no longer necessary; (2) revise and update its interpretations of the Act; and (3) send to State member banks through the Reserve Banks an announcement and explanation of the new provisions. The Board's actions are intended for simplification and clarification, and the revision of the interpretations will not impose any new requirements not contained in the Act.

EFFECTIVE DATE: March 10, 1979.

**FOR FURTHER INFORMATION
CONTACT:**

Carl V. Howard, Attorney, Legal Division, Board of Governors of the Federal Reserve System, Washington, D.C. 20551 (202/452-3786).

SUPPLEMENTARY INFORMATION: The Bank Service Corporation Act (the "Act") (12 U.S.C. 1861-65), as originally adopted, required that, when a State member bank has bank services performed for it (such as check sorting and posting of interest on savings accounts), satisfactory assurances must be furnished to the Board that the performance of the services will be subject to the Board's regulation and examination to the same extent as if the services were being performed by the bank itself on its own premises. The purpose was to make certain that the appropriate Federal banking agency would not be frustrated in its examination of a bank

subject primarily to its supervision because the bank's records have been transferred to another organization or some other organization is carrying out part or all of the bank's functions. Regulation S, "Bank Service Arrangements" (12 CFR Part 219), was issued by the Board in 1963 to implement the Act by specifying when and in what form assurances shall be provided to the Federal Reserve System.

However, the Congress has taken a more direct approach to supervision of bank service arrangements through an amendment of the Act contained in section 308 of the Financial Institutions Regulatory and Interest Rate Control Act of 1978 (Pub. L. 95-630; 92 Stat. 3677). Effective March 10, 1979, the performance of bank services for State member banks or their subsidiaries or affiliates will be subject to regulation and examination by the Board as a matter of law without the necessity for "assurances." A State member bank will be required to notify the Board of the existence of a bank service arrangement within 30 days after the making of the service contract or the performance of the service, whichever occurs first.

In the course of reviewing Regulation S in its Regulatory Improvement Project, the Board has concluded that the regulation will no longer be necessary and should be rescinded in the light of the legislative change. The provisions regarding "assurances" will become obsolete. The only provision of the regulation that will continue to have effect is the rule that the performance of legal, advisory, and administrative services, such as transportation or guard services, is not subject to examination unless specifically requested by the Board. This rule, which essentially is an interpretation of the term "bank services" in section 1(b) of the Act (12 U.S.C. 1861(b)), will be incorporated in the Board's published interpretations. No new regulatory provisions are considered necessary to reflect the recent amendment of the Act.

As in the past, the letter notifying the Board of the bank service arrangement is to be sent to the Federal Reserve Bank in whose district the State member bank has its main office. If a bank has an existing bank service arrangement on March 10, 1979, and has already furnished assurances regarding the arrangement in compliance with Regulation S, no additional notification regarding the arrangement is necessary.

As a further effort to improve its regulations, the Board is revising, updating, and streamlining its interpretations. The only substantive rulings being added are taken from: (1) An interpretation published in the *Federal Reserve Bulletin* (48 Fed. Res. Bull. 1429 (1962)) but not in the *Code of Federal Regulations*; and (2) the last

sentence of section 219.4 relating to legal, advisory, and administrative services (discussed above).

The Board is also adding a short summary paragraph at the beginning of each interpretation to facilitate the public's finding of information and lessen the burden of reading materials that may not be relevant to the researcher's interest. Of course, if reliance is to be placed upon the interpretation, the full text must be consulted since the summary is only a paraphrase of the ruling rather than the ruling itself.

The Board is asking the Federal Reserve Banks to notify State member banks of the statutory and regulatory changes and to explain compliance with the amended Act.

The procedures of 5 U.S.C. 553(b) regarding notice, public participation and deferred effective date were not followed in connection with these regulatory changes because: (1) The Board finds that public participation is unnecessary since the rescission of the regulation will result in neither the granting of authority to the persons regulated, nor the imposition or relaxing of any requirements; and (2) rulemaking procedures do not apply to interpretive rules. For similar reasons, the expanded rulemaking procedures set forth in the Board's policy statement of January 15, 1979 (44 F.R. 3957) do not apply.

To implement these regulatory changes, the following actions are being taken under the Board's authority in 12 U.S.C. 1861-65:

PART 219—[REVOKED]

1. 12 CFR Part 219 is hereby revoked.*

**PART 250 MISCELLANEOUS
INTERPRETATIONS**

2. The table of contents of 12 CFR Part 250 is amended by adding at the end of the table a new heading and three new section titles to read as follows:

BANK SERVICE ARRANGEMENTS

Sec.

250.300 Kinds of bank servicers subject to Board examination under the Bank Service Corporation Act.

250.301 Scope of investment authority and notification requirement under the Bank Service Corporation Act.

250.302 Applicability of Bank Service Corporation Act to bank credit card service organization.

3. 12 CFR Part 250 is amended by adding new sections §§ 250.300-250.302 immediately after a new heading,

* 12 CFR 219.101 is a cross reference to 12 CFR 225.115. The revocation of the former is not intended to result in the revocation of the latter.

"BANK SERVICE ARRANGEMENTS," to read as follows:

BANK SERVICE ARRANGEMENTS

§ 250.300 Kinds of bank servicers subject to Board examination under the Bank Service Corporation Act.

Summary. The performance of bank services for State member banks is subject to the Board's regulation and examination, regardless of the nature of the bank servicer, including servicers that are national banks; State nonmember insured banks; non-profit, no-stock credit card servicing organizations; and servicing subsidiaries of bank holding companies.

Text. (a) Since the enactment of the Bank Service Corporation Act (the "Act") (12 U.S.C. 1861-65), the Board has on several occasions considered whether performance of "bank services" (as that term is defined in section 1(b) of the Act) for State member banks is subject to regulation and examination by the Board under section 5 of the Act if (1) the bank servicer is not a "bank service corporation" (as that term is defined in the Act), or (2) the bank servicer is a bank itself. In each instance, based on the reasoning set forth below, the Board expressed the view that section 5 of the Act applied to any organization that performed bank services for State member banks, including national banks; another State member bank; State nonmember insured banks; servicing subsidiaries of bank holding companies; and non-profit, no stock credit card servicing organizations.

(b) The Senate Committee on Banking and Currency stated with regard to section 5 of the Act, as enacted in 1962, 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. Rep. No. 2105, 87th Cong. 3 (1962)). 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.R. Rep. No. 2062, 87th Cong. 3 (1962)).

(c) Section 5 of the Act is not limited by its terms to "bank service corporations" as defined in the Act; nor, in the Board's opinion based on the legislative history of the Act, should such a limitation be implied. The Board concludes that the performance of bank services for State member banks by or-

ganizations that are not bank service corporations is also subject to Board regulation and examination.

(d) If the bank servicer is a national bank or a State nonmember insured bank, its performance of bank services for State member banks is subject to Board regulation and examination, despite the fact that the servicer is subject primarily to regulation and examination by one of the other Federal banking agencies. By the same token, the performance of bank services by a State member bank for a national bank or State nonmember insured bank is subject to regulation and examination by the Comptroller of the Currency or the Federal Deposit Insurance Corporation, respectively. The purpose of section 5 of the Act is to make certain that the appropriate Federal banking agency will be able effectively to exercise its responsibilities with respect to a bank subject primarily to its supervision.

(e) It is important to note that the scope of the Board's regulation and examination under section 5 of the Act does not extend to all affairs of the bank servicer, but only to the "bank services" performed for a State member bank and only to the same extent as if the services were being performed by the State member bank itself on its own premises.

§ 250.301 Scope of investment authority and notification requirement under the Bank Service Corporation Act.

Summary. (a) The authority of State member banks under the Bank Service Corporation Act to invest in bank service corporations is limited to investments in corporations that perform "bank services" solely.

(b) A State member bank is required by the Act to notify the Board only of the performance of "bank services" for it.

(c) "Bank services" will not usually be regarded as including legal, advisory, and administrative services, such as transportation or guard services.

Text. (a) Section 2(a) of the Bank Service Corporation Act (12 U.S.C. 1861-65) 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 the applicable State law.

(b) "Bank service corporation" is defined in section 1(c) of the Act to mean "a corporation organized to per-

form 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." Section 4 of the Act states that "no bank service corporation may engage in any activity other than the performance of bank services for banks." Thus, the investment authority created by section 2(a) is limited to corporations that are engaged solely in the provision of "bank services" to banks, as that term is defined in the Act.

(c) In addition to its grant of investment authority, the Act also requires State member banks to notify the Board within 30 days of the execution of a contract for "bank services" or the actual provision of such services, whichever occurs first. Moreover, the Act authorizes the Board to regulate and examine the performance of "bank services." Thus, the scope of the Act's notification and examination requirements also is limited to "bank services."

(d) The term "bank services" is defined in section 1(b) of 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."

(e) Bearing importantly upon the meaning of "bank services" is the following quotation from the Report of the Senate Committee on Banking and Currency: "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 bank's 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." (S. Rep. No. 2105, 87th Cong. 3 (1962)).

(f) On the basis of the Act's definition of "bank services", the limitation contained in section 4 of the Act, and the preceding quotation from the Act's legislative history, it is apparent that the term "bank services" is essentially limited to clerical and similar services. For example, the term would not usually be regarded as including legal, advisory, and administrative services, such as transportation or guard services.

(g) Thus, State member banks generally may rely on the Act to justify investment only in a corporation that is engaged solely in performing one or more of the services contained in the definition of "bank services" in section 1(b), or a service similar to one of those services, and only if those services are provided solely to banks. Investment in a corporation providing any other services, such as the type of services described in the above quotation from the Act's legislative history, generally is not permitted on the basis of this Act, unless such services are legitimately incidental to the provision of "bank services" by that corporation.

(h) Since the notification required by section 5 of the Act, as amended, also is based on the provision of "bank services," such notification need only be provided with regard to the provision of one or more of the services

enumerated in section 1(b) of the Act or a service similar to one of those services.

§ 250.302 Applicability of Bank Service Corporation Act to bank credit card service organization.

Summary. Although a non-profit, no-stock service organization in which no bank has made an investment is not a "bank service corporation" as defined in the Bank Service Corporation Act, that organization's credit card servicing activities are "bank services" as defined in the Act and thus subject to the notification requirement of section 5 of the Act.

Text. (a) The Board of Governors has considered whether the Bank Service Corporation Act (12 U.S.C. 1861-65), is applicable where a bank credit card plan of a State member bank and other banks used the facilities of a non-profit, no-stock service organization.

(b) The functions of the service organization include the following: (1) Performing cardholder accounting for participating banks; (2) developing information concerning each credit card and holder, including such holder's current balance owing to the card issuing bank and the amount of such balance that is delinquent; (3) assisting in procedures relating to the presentation and settlement of drafts and credit memoranda; (4) developing pro-

cedures relating to credit card security control; (5) upon telephonic request, advising merchants and participating banks respecting credit authorizations above certain specified limits; and (6) compiling lists of participating merchants.

(c) The Board expressed the view that because the service organization has no stock and the State member bank does not otherwise "invest" therein by "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" (section 1(d) of the Act), the service organization is not a "bank service corporation" within the meaning of section 1(c) of the Act.

(d) However, the Board concluded that the functions described above do constitute "bank services" as defined in section 1(b) of the Act. Accordingly, the State member bank is required to notify the Board (through the appropriate Federal Reserve Bank) of the performance of the services for the bank in accordance with section 5 of the Act.

Effective date: March 10, 1979.

Board of Governors of the Federal Reserve System, March 5, 1979.

THEODORE E. ALLISON,
Secretary of the Board.

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