

**FEDERAL RESERVE BANK
OF NEW YORK**

[Circular No. 9790
January 22, 1985]

BANK HOLDING COMPANIES
Request for Comment on Proposal to Allow
Certain Relationships Between Bank Holding Companies and
Their "Nonbank Bank" Subsidiaries

*To All Bank Holding Companies, 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 has requested comment on a proposal that would lift some restrictions on the operation of "nonbank bank" affiliates of bank holding companies. Comment is requested by February 14.

The Board has received requests to permit the following types of activities by nonbank banks: loan and deposit account data processing, including the preparation of customer account statements; check clearing; account maintenance and review services; payroll and expense processing services; financial controls and accounting services; audit, compliance, and general legal support services; management information services; personnel services; purchasing services; facilities support services; certain trust services; and establishment of officer and director interlocks.

Printed on the following pages is the text of the Board's proposal, which has been reprinted from the *Federal Register* of January 15. Comments thereon should be submitted by February 14, 1985, and may be sent to our Domestic Banking Applications Department.

E. GERALD CORRIGAN,
President.

FEDERAL RESERVE SYSTEM

12 CFR Part 225

[Docket No. R-0536]

Regulation Y; Permissible Transactions Between Bank Holding Companies and Their Nonbank Bank Subsidiaries

AGENCY: Board of Governors of the Federal Reserve System (FRB).

ACTION: Solicitation of public comments.

SUMMARY: The Federal Reserve Board is soliciting comment on whether the Board should permit bank holding companies that own nonbank banks (institutions that are chartered as banks but which either do not accept demand deposits or do not make commercial loans) to engage in certain transactions or establish or continue certain arrangements with their nonbank bank subsidiaries. Specifically, such transactions or arrangements would include:

1. The provision of certain internal administrative services to a nonbank bank subsidiary;
2. Continuation of trust service and investment arrangements that existed between a bank holding company and its trust company subsidiary prior to the trust company's conversion to a nonbank bank; and
3. Officer and director interlocks.

DATE: All comments should be received by the Board by February 14, 1985.

ADDRESS: All comments, which should refer to Docket No. R-0536, should be mailed to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, or delivered to Room B-2223, 20th & Constitution Avenue, NW., Washington, D.C., between 8:45 a.m. and 5:15 p.m. weekdays. Comments may be inspected in Room B-1122 between 8:45 a.m. and 5:15 p.m. weekdays.

FOR FURTHER INFORMATION CONTACT: J. Virgil Mattingly, Associate General Counsel (202/452-3430), Carl Howard, Senior Counsel (202/452-3786), or Melanie L. Fein, Senior Attorney (202/452-3594), Legal Division.

SUPPLEMENTARY INFORMATION: On March 23, 1984, the Board approved the application by U.S. Trust Corporation to convert its state chartered Florida trust company into a nationally chartered "nonbank bank" that would accept

demand deposits and make consumer, but not commercial, loans as defined by the Board. *U.S. Trust Corporation*, 70 Federal Reserve Bulletin 371 (1984). In its order approving the *U.S. Trust* application, the Board stated that it was constrained to approve the application based on the literal definition of the term "bank" in the Bank Holding Company Act. The Board expressed its concern that the use of these limited purpose banks to avoid the objectives of the Bank Holding Company Act is inconsistent with the intention of Congress and that the proliferation of similar transactions would seriously undermine the policies of the Bank Holding Company Act. The Board found that use of this device presents the potential for a significant, haphazard, and possibly dangerous alteration of the nation's banking structure without Congressional action on the underlying policy issues. In view of these concerns, the Board approved the application subject to the following conditions:

(1) Applicant would not operate the nonbank bank's demand deposit taking activities in tandem with any other subsidiary or other financial institutions;

(2) Applicant would not link in any way the demand deposit and commercial lending services that define a bank under the Act; and

(3) The nonbank bank would not engage in any transactions with affiliates, other than the payment of dividends to Applicant or the infusion of capital by Applicant into the nonbank bank, without the Board's approval.

These conditions were established to ensure that a nonbank bank would be independent of its affiliates and that its banking activities would not be integrated with those of its affiliates such that the institution would be a "bank" under the Act. These conditions were intended to prevent evasion of the basic policy of the Act to separate banking and commerce and to maintain compliance with the Act's limitations on interstate banking. Thus, the framework was intended to establish a set of requirements applicable to the acquisition and operation of nonbank banks by both banking and nonbanking organizations that would assure that these institutions would remain independent and not integrated into the parent's operations in such a manner as to effect a combination of banking and commerce or otherwise prohibited interstate deposit taking and

commercial lending.

Following the Board's approval of the *U.S. Trust* application, a number of bank holding companies applied to acquire similar nonbank banks. The Board has approved several of these applications to date, subject to the same conditions it established in its *U.S. Trust* order.¹

Several of the bank holding companies that have received Board approval to acquire nonbank banks, as well as a number of bank holding companies with applications to acquire nonbank banks pending before the Board, have requested the Board's approval for certain limited transactions or arrangements between their nonbank bank subsidiaries and other affiliates. These requests have been made pursuant to the third *U.S. Trust* condition, which prohibits transactions with affiliates but contemplates that the Board would consider requests for exceptions to this prohibition. The types of proposed transactions and arrangements for which approval is requested include the provision by a parent bank holding company to its nonbank bank subsidiary of internal data processing and bookkeeping support services, check clearing services, and certain trust services, and the establishment of management interlocks.

Internal administrative support services. The internal administrative support services that bank holding companies have requested to provide to their nonbank bank affiliates include: Loan and deposit account data processing, including the preparation of customer account statement's check clearing; account maintenance and review services; payroll and expense processing services; financial controls and accounting services; audit, compliance, and general legal support services; management information services; credit policy services; loan document preparation services; personnel services; purchasing services; and facilities support services.

The bank holding companies have stated that a complete ban on these internal transactions with their nonbank bank affiliates would create practical difficulties and entail substantial

¹ *Bankers Trust New York Corporation*, 71 Federal Reserve Bulletin 51 (1985); *Bank of Boston Corporation*, 71 Federal Reserve Bulletin 55 (1985); *Suburban Bancorporation*, 71 Federal Reserve Bulletin 61 (1985) *First National State Bancorporation*, (Order of December 19, 1984).

additional cost in the operation of nonbank banks; and that the parent is merely providing traditional support services to its subsidiary consistent with the Bank Holding Company Act, which specifically contemplates that bank holding companies may provide such services to their subsidiaries. 12 U.S.C. 1843(c)(1)(C).

The Board staff has advised the Board that, in staff's opinion, an absolute prohibition on the provision of services by the parent to its nonbank bank would not appear necessary to carry out the purposes of the *U.S. Trust* conditions.

The provision by a parent or its affiliates to a nonbank bank of such internal administrative services does not impair the prohibition on linking demand deposits and commercial loans, particularly since it does not involve contact of the affiliate with customers of the nonbank bank. Nor, in staff's opinion, does the provision of these services result in an integration of the banking activities of the nonbank bank with those of its other affiliates in a manner that would cause the nonbank bank to fall within the present definition of "bank" in the Bank Holding Company Act. In the situation of the parent providing limited administrative services to the subsidiary nonbank bank, the staff has pointed out that the parent is not using the nonbank bank to further its other business activities, and the parent and its affiliates are not customers of the nonbank bank; nor do they use the nonbank bank to obtain access to banking products or services.

The Board is requesting public comment on whether the provision of the internal administrative support services requested should be allowed and whether the provision of such administrative services would lead to a commingling of banking and commerce when a nonbanking company provides

such support services to its nonbank bank subsidiary.

Trust Company Agreements and Arrangements. Several bank holding companies also have urged that they be permitted to continue trust service and investment agreements or arrangements with their nonbank banks where the nonbank bank was originally a limited purpose trust company. Such agreements and arrangements generally allow an affiliate to prepare account statements and tax returns, keep custody of securities, maintain records, collect income and other monies due and collectable from securities, credit and disburse income as directed by the nonbank bank, execute investment orders, redeem maturing securities, and make recommendations to the nonbank bank relating to investments and proxies and render other advice. In addition, such arrangements would allow customers of the nonbank bank to continue to invest in common trust funds maintained by affiliated banks.

In all cases, these trust and investment service agreements predated the conversion of a limited purpose trust company to a nonbank bank and are permissible under the Board's Regulation Y authorizing bank holding companies to provide trust and investment services.

The Board is requesting comment on whether such preexisting trust and investment service arrangements should be allowed.

Common Officers and Directors. The question of whether a nonbank bank may share common officers and directors with affiliates also has been raised by several bank holding companies. Such interlocking management relationships raise issues of consistency with the *U.S. Trust* conditions.

The Board is soliciting comments on whether some limitations on common officers and directors are necessary in order to avoid integrated operations involving demand deposits and commercial loans or, in the case of nonbanking concerns, commingling of banking and commerce. In particular, the Board requests comments on whether such issues should be resolved on a case by case basis subject to general guidelines for management interrelationships. The Board requests comment on whether such guidelines should require that a majority of a nonbank bank's directors could not be officers, directors, or employees of the parent holding company or any other subsidiary of that company, and, with respect to officers, that no officer of a nonbank bank could be an officer, director or employee of any affiliate engaged in a demand deposit or commercial lending activity prohibited to the nonbank banks.

The Board believes that a public comment period on these issues would be appropriate in view of the public interest in nonbank bank and their operations generally. The Conference of State Bank Supervisors has requested that the Board provide a public comment period. In addition, the Independent Bankers Association of America has requested an opportunity to submit its views on this matter to the Board.

List of Subjects in 12 CFR Part 225

Banks, banking.

By Order of the Board of Governors of the Federal Reserve System, January 11, 1985.

William W. Wiles,
Secretary of the Board.

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