FEDERAL RESERVE BANK OF NEW YORK

[Circular No. **10783**
May 10, 1995]

STATE MEMBER BANKS

Interpretation of Regulation H Regarding the Establishment of Loan Production Offices

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

The following statement has been issued by the Board of Governors of the Federal Reserve System:

> The Federal Reserve Board has issued an interpretation of its Regulation H relating to the establishment of loan production offices and "back office" facilities of state member banks.
>
> The interpretation provides that a "back office" facility established by a state member bank is not considered a branch of the bank.
>
> Also, the interpretation states that loans originated by a loan production office of a bank may be approved at a "back office" location — and not considered a branch — if the proceeds of the loan are received by the customer at a location other than a loan production office or a "back office" facility.
>
> This interpretation provides parity between state member banks and national banks in this respect.

Printed on the following pages is the text of the Board's notice in this matter, as published in the *Federal Register.* Questions may be directed to our Banking Applications Department (Tel. No. 212-720-5861).

WILLIAM J. MCDONOUGH,
President.

FEDERAL RESERVE SYSTEM

12 CFR Part 208

[Regulation H; Docket No. R–0873]

Membership of State Banking Institutions in the Federal Reserve System

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule; interpretation.

SUMMARY: The Board is issuing an interpretation of the provisions of its Regulation H, Membership of State Banking Institutions in the Federal Reserve System, concerning the establishment of loan production offices and "back office" facilities by state member banks. The interpretation provides that a state member bank may establish a back office facility that is not accessible to the public without such a facility being considered to be a branch. The interpretation also provides that loans originated by a loan production office may be approved at a back office location, rather than at the main office or a branch of the bank, without the loan production office being considered to be a branch, if the proceeds of loans originated by the loan production office are received by customers at locations other than a loan production office or back office facility. This interpretation is intended to provide parity between state member banks and national banks with respect to the establishment of loan production offices and back office facilities.

EFFECTIVE DATE: April 6, 1995.

FOR FURTHER INFORMATION CONTACT: Lawranne Stewart, Senior Attorney (202/452–3513), Legal Division. For the hearing impaired *only*:, Telecommunications Device for the Deaf ("TDD"), Dorothea Thompson (202/452–3544).

SUPPLEMENTARY INFORMATION: In connection with the acquisition of a mortgage company by a state member bank, the Board has been asked to consider two issues with respect to the types of facilities that a state member bank may establish to engage in activities related to lending at locations that are not approved branches: (1) Whether a state member bank may establish a "back office" facility that is not accessible to the public without

such a facility being considered to be a branch of the bank; and (2) whether a loan production office will be considered to be a branch of the bank if it takes loan applications and performs related functions, but the loans are approved at locations other than an approved branch or main office of the bank. Under the Board's prior interpretation concerning loan production offices, published at 12 CFR 250.141, an office that engaged in loan origination activities was not considered to be a branch when the loans were approved and funds disbursed at the head office or a branch of the bank. "Back office" facilities that are not accessible to the public were not addressed in the prior interpretation.

State member banks are subject to the same limitations on branching as national banks.[1] Under the McFadden Act, national banks may establish branches only at locations at which a state bank would be permitted to establish a branch.[2] Interpreting the branching restrictions of the McFadden Act, the Supreme Court has stated that the purpose of the McFadden Act was to maintain competitive equality between national and state banks, and that the determination as to whether a facility was a branch must be based on the convenience of the customer, rather than on the technical or legal relationship between the customer and the bank.[3] In later cases addressing automated teller machines, the courts generally have rejected arguments that money is lent at the time and place where a loan or line of credit is approved, and instead found that money is lent for the purposes of the McFadden Act when the customer actually receives the funds and interest begins to run on the loan.[4]

[1] Federal Reserve Act, section 9, paragraph 3 (12 U.S.C. 321); Regulation H, § 208.9 (12 CFR 208.9).

[2] 12 U.S.C. 36(c). Under the McFadden Act, "branch" is defined to include "any branch bank, branch office, branch agency, additional office, or any branch place of business . . . at which deposits are received, or checks are paid, or money lent." 12 U.S.C. 36(f).

[3] *First National Bank of Plant City v. Dickinson*, 396 U.S. 122 (1969).

[4] *E.g., IBAA v. Smith*, 534 F.2d 921 (D.C. Cir. 1976); *Colorado ex rel. State Bank Brd. v. First Nat'l Bank*, 540 F. 2d 497 (10th Cir. 1976); *Illinois v. Continental Illinois NT&SA*, 409 F. Supp. 1167 (N.D. Ill. 1975), aff'd in relevant part, 536 F.2d 176 (7th Cir. 1976), cert. denied, 429 U.S. 871 (1976). Only one federal district court case stands in which the court concluded that a loan is made at the time that the bank and its customer reach agreement on the terms of the loan, and not at a location where only the proceeds of the loan are disbursed. *See Oklahoma ex. rel. State Banking Board v. Utica Nat'l Bank and Trust*, 409 F. Supp. 71 (N.D. Okla. 1975). This decision was criticized in each of the appellate court opinions that have addressed this issue.

The Board previously had determined that an office engaged in preliminary or servicing functions, such as soliciting loan applications and assembling credit information, is not lending money and therefore is not a "branch" for the purposes of the McFadden Act if the loans originated by the office are approved and the funds disbursed at the main office or an approved branch of the bank.[5] Whether a loan production office should be considered to be a branch if loans originated by the office are approved at locations other than the main office or a branch of the bank therefore depends on whether the location where loan approval takes place enhances the convenience to the customer and therefore provides a competitive advantage to the bank.

Back office facilities that are not accessible to the public are not visited by customers and do not appear to provide customers of the bank with any greater level of convenience. From the point of view of a customer whose loan has been originated at a loan production office, there does not appear to be any difference in the convenience based on whether the loan is approved at the back office facility or at a branch of a bank, as it is unlikely that the customer will visit either location.

Accordingly, the Board has concluded that, insofar as federal law is concerned, a state member bank may establish a back office facility without such a facility being considered to be a branch. The Board also has determined that loans originated by a loan production office may be approved at a back office location, rather than at the main office or a branch of the bank, without the loan production office being considered to be a branch under federal law, if the proceeds of loans originated by the loan production office are received by the customer at locations other than a loan production office or back office facility. This interpretation supersedes those portions of the Board's prior interpretation, published at 12 CFR 250.141, that concern loan production offices.

Administrative Procedures and Regulatory Flexibility Acts

The provisions of the Administrative Procedures Act concerning notice and comment are not applicable to interpretative rules. 5 U.S.C. 553(b). Because no notice of proposed rulemaking is required, a statement concerning the effects of the rule on small entities is also not required under the Regulatory Flexibility Act. 5 U.S.C. 604. The Board notes, however, that the interpretation provides greater flexibility to state member banks of all sizes in structuring their activities.

[5] 12 CFR 250.141

List of Subjects in 12 CFR Part 208

Accounting, Agriculture, Banks, Banking, Confidential business information, Crime, Currency, Federal Reserve System, Mortgages, Reporting and recordkeeping requirements, Securities.

For the reasons set forth in the preamble, 12 CFR part 208 is amended as set forth below:

PART 208—MEMBERSHIP OF STATE BANKING INSTITUTIONS IN THE FEDERAL RESERVE SYSTEM (REGULATION H)

1. The authority citation for part 208 continues to read as follows:

Authority: 12 U.S.C. 36, 248(a), 248(c), 321–338a, 371d, 461, 481–486, 601, 611, 1814, 1823(j), 1828(o), 1831o, 1831p–1, 3105, 3310, 3331–3351, and 3906–3909; 15 U.S.C. 78b, 781(b), 781(g), 781(i), 78o–4(c)(5), 78q, 78q–1, and w; 31 U.S.C. 5318.

2. In Subpart E, § 208.123 is added in numerical order to read as follows:

§ 208.123 Loan production offices and "back office" facilities.

(a) *Scope.* The Board has considered two issues:

(1) Whether a state member bank may establish a "back office" facility that is not accessible to the public and is not visited by customers without such a facility being considered to be a branch of the bank; and

(2) Whether a loan production office will be considered to be a branch of the bank if it takes loan applications and performs related functions, but the loans are approved at locations other than an approved branch or main office of the bank and funds are not disbursed at the loan production office.

(b) *Authority.* State member banks are subject to the same limitations on branching as national banks. Federal Reserve Act, section 9, paragraph 3 (12 U.S.C. 321). Under the McFadden Act (44 Stat. 1228), national banks may establish branches within a state only at locations at which a state bank would be permitted to establish a branch. 12 U.S.C. 36(c). For the purposes of the McFadden Act, "branch" is defined to include "any branch bank, branch office, branch agency, additional office, or any branch place of business * * * at which deposits are received, or checks are paid, or money lent." 12 U.S.C. 36(f). Interpreting the branching restrictions of the McFadden Act, the Supreme Court has stated that the purpose of the McFadden Act was to

maintain competitive equality between national and state banks, and that the determination as to whether a facility was a branch must be based on the convenience of the customer, rather than on the technical or legal relationship between the customer and the bank. In later cases addressing automated teller machines, the courts generally have rejected arguments that money is lent at the time and place where a loan or line of credit is approved, and instead found that money is lent for the purposes of the McFadden Act when the customer actually receives the funds and interest begins to run on the loan. *See, e.g., IBAA* v. *Smith,* 534 F.2d 921 (D.C. Cir. 1976).

(c) *Interpretation.* The Board previously had determined that an office engaged in preliminary or servicing functions is not lending money and therefore is not a "branch" for the purposes of the McFadden Act if the loans originated by the office are approved and the funds disbursed at the main office or an approved branch of the bank. *See* 12 CFR 250.141. Whether a loan production office should be considered to be a branch if loans originated by the office are approved at locations other than the main office or a branch of the bank depends on whether the location where loan approval takes place enhances the convenience to the customer and therefore provides a competitive advantage to the bank. Back office facilities that are not accessible to the public are not visited by customers and do not appear to provide customers of the bank with any greater level of convenience. From the point of view of a customer whose loan has been originated at a loan production office, there does not appear to be any difference in the convenience based on whether the loan is approved at the back office facility or at a branch of a bank, as it is unlikely that the customer will visit either location. Based on this analysis, the Board has concluded that a state member bank may establish a back office facility without such a facility being considered to be a branch for the purposes of the McFadden Act. The Board also has determined that loans originated by a loan production office may be approved at a back office location, rather than at the main office or a branch of the bank, without the loan production office being considered to be a branch, provided that the proceeds of loans originated by the loan production office are received by the customer at locations other than a loan production office or back office facility. This interpretation supersedes the Board's prior interpretation, published at 12 CFR 250.141, as it applies to loan production offices.

By order of the Board of Governors of the Federal Reserve System, March 31, 1995.

Barbara R. Lowrey,

Associate Secretary of the Board.

[FR Doc. 95–8404 Filed 4–5–95; 8:45 am]

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