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FEDERAL RESERVE SYSTEM

12 CFR Parts 204 and 209

[Regulations D and I; Docket No. R-0963]

Reserve Requirements of Depository Institutions and Issue and Cancellation of Capital Stock of Federal Reserve Banks

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: The Board is amending Regulations D and I, Reserve Requirements of Depository Institutions and Issue and Cancellation of Capital Stock of Federal Reserve Banks, respectively, to define the location of a depository institution for purposes of Federal Reserve membership and reserve account maintenance. These amendments will facilitate interstate banking.

EFFECTIVE DATE: October 1, 1997.

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SUPPLEMENTARY INFORMATION: Recent statutory changes have eliminated many barriers to interstate banking.^{1/} Consequently, the number of depository institutions that operate branches in more than one Federal Reserve District is expected to increase. On January 2, 1998, the Federal Reserve Banks will begin to implement a new account structure that will provide a single Federal Reserve account for each domestic depository institution.

The advent of interstate banking raises questions as to how certain provisions of the Federal Reserve Act (FRA)^{2/} will apply to banks with interstate branches. Many of these questions are related to a bank's "location." To date, the Board and the Federal Reserve Banks generally have interpreted the term "location," as used in the FRA, to mean the geographic location of a bank, heavily influenced by the location specified in the bank's charter, or if no charter location is specified, the location of the bank's head office. This interpretation, however, may not always be appropriate in an interstate branching environment, where a bank may have offices in multiple Federal Reserve Districts and do most of its business in places other than its charter or head office location. In March 1997, the Board proposed

^{1/}See, the Riegle-Neal Interstate Banking and Branching Efficiency Act, Pub. L. 103-328, 108 Stat. 2338 (1994).

^{2/}12 U.S.C. 221 et seq.

amendments to its Regulation D (12 CFR part 204, Reserve Requirements of Depository Institutions) and Regulation I (12 CFR part 209, Issue and Cancellation of Capital Stock of Federal Reserve Banks) to define "location" for purposes of the Federal Reserve membership and reserve account maintenance (62 FR 11117, March 11, 1997).

Background

A member bank, even if it has interstate branches, must be a member of a particular Federal Reserve Bank. The membership question is closely related to other location issues such as where reserve accounts are located and where account entries are posted. Every national bank is required to become a member and stockholder of the Federal Reserve Bank of its district (FRA section 2(1)). State banks may apply to the Board to subscribe to the stock of the Federal Reserve Bank organized within the district in which the applying bank is located (FRA section 9(1)). These provisions suggest that membership is limited to one Federal Reserve Bank and that membership is to be determined by the geographical location of the bank.

A bank must hold reserves at the Federal Reserve Bank of which it is a member or where it maintains an account (FRA section 19(c)(1)). Therefore, a nonmember bank would hold its reserve account at the Reserve Bank where it

maintains an account for purposes of check collection and other payments services. FRA section 13(1) provides that the nonmember bank may maintain this clearing account with the Federal Reserve Bank of its district.

Charter or head office location is the status quo under the FRA as to where a bank is located for membership purposes and nonmember reserve account purposes. The National Bank Act requires a national bank's organization certificate to state the place where its operations of discount and deposit are to be carried on, designating the state, territory, or district, and the particular county and city, town, or village (12 U.S.C. 22). State laws may be less specific with respect to state-chartered banks, and the determination of the bank's location may not be ascertainable from the bank's charter.

Under a strict interpretation of the charter/head office rule, a bank could be a member only of the Reserve Bank whose district encompasses the location specified in its charter or, in the case of a state bank with no specific charter location, the location of its head office. For a bank with interstate branches, however, this location test may not be the appropriate means of determining where the bank is located for membership or reserve account purposes. An interstate bank may have its main office or do the bulk of its business somewhere other than its charter location and may wish to establish a Federal Reserve Bank relationship

closer to its business headquarters. Similarly, a bank holding company with subsidiary banks in multiple Federal Reserve Districts that manages those banks as a combined business may wish to centralize operations in a single district. In addition, the Board and the Federal Reserve Banks may find it more efficient to administer a bank's account and perform other functions in a district other than the district encompassing the charter or head office location.

Board's proposal

Section 9(1) of the FRA authorizes the Board to prescribe rules and regulations governing applications by state banks to subscribe to the stock of the Federal Reserve Bank organized within the district in which the applying bank is located. Section 2(1) of the FRA requires national banks to become member banks in accordance with the provisions of the FRA, and section 11(i) gives the Board general authority to write rules necessary to perform its duties, functions, and services under the FRA. Accordingly, the Board proposed to amend Regulation I to set forth a definition of "location" for the purpose of acquiring Federal Reserve Bank stock. This amendment also would help answer other member bank location questions related to reserve account maintenance, supervision, and other issues.

The proposed Regulation I provision stated a general rule that, for membership purposes, a bank is considered to be located in the Federal Reserve

District specified in the bank's charter or organizing certificate, or, if no such location is specified, the location of its head office. The Board could make exceptions to the general rule for a particular bank after considering certain criteria. Thus, if the bank's location were uncertain or its location based on its charter, organizing certificate, or head office differed from the location where it conducted most of its business, the Board, after consultation with the relevant Reserve Banks, could designate the appropriate location for membership purposes. (The relevant Reserve Banks are the Reserve Bank whose district contains the bank's charter or head office location and the Reserve Bank in whose district the bank is proposed to be located.)

One consideration in making this determination would be whether any other laws would require the bank to have a relationship with a particular Reserve Bank. For example, Massachusetts and Nebraska laws provide that state banks may become members of the Boston and Kansas City Reserve Banks, respectively.^{3/} The Board could also consider other criteria, such as the business needs of the bank, where the head office of the bank is located, where the bank does the bulk of its business, and the location that would allow the bank, the Board, and the Reserve Banks to perform their functions most efficiently and effectively. For example, the

^{3/}Mass. Gen. L. ch. 167F, section 8 (1996) and Neb. Rev. Stat. section 8-130 (1996).

Board might consider the efficiency of bank supervisory functions, account management, and Federal Reserve monetary policy. Generally, these amendments would not affect current relationships between banks and Federal Reserve Banks. A bank that already owns stock in or has an account at a Federal Reserve Bank may, but need not, seek a Board determination to change its location. The Board anticipates that the "location" issue will arise principally from mergers of existing banks or other changes in the organization or management of bank holding companies. Ordinarily, the Board expects that "location" decisions would be worked out between the Reserve Banks and the bank.

Although the proposed Regulation I amendment would be sufficient to determine where a member bank's reserve account would be located, the Board also proposed to amend Regulation D to clarify the location of nonmember bank reserve accounts. The Board proposed this amendment under the authority of section 19(c)(1) of the FRA, which provides that depository institutions must hold reserves subject to such rules and regulations that the Board may prescribe. The Regulation D amendment is similar to the Regulation I proposal and would, in effect, assure that nonmember banks are treated comparably to member banks for account location purposes.

Regulation D also applies to Edge and agreement corporations and U.S. branches and agencies of foreign banks. Section 25A of the FRA requires Edge corporations to carry reserves in the same amounts as the Board prescribes for member banks and authorizes the Board to write rules governing the operations of such corporations. Section 25 of the FRA also authorizes the Board to require agreement corporations to maintain reserves. Section 7 of the International Banking Act provides that Federal branches and agencies of foreign banks are subject to the FRA's reserve requirement provisions (including section 19(c)) as if they were member banks. That Act also provides that the Board may impose the same requirements on state-licensed branches and agencies of foreign banks after consultation and in cooperation with the state bank supervisory authorities. The Board requested comment on whether it should apply the same or similar criteria for determining the location of reserve accounts for U.S. branches and agencies of foreign banks and Edge and agreement corporations as it does for depository institutions.

Summary of public comments

The Board received 12 comments on the proposed amendments from the following categories of entities:

Federal Reserve Banks

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Bank holding companies	3	
Commercial banks	2	
Trade associations	2	
Credit unions		1
Total		12

All of the commenters supported the Board's proposed amendments in general and agreed that the amendments would provide operational efficiencies and flexibility that will be necessary in an interstate banking environment.

Role of affected bank. Three commenters asked the Board to clarify that, when making a location determination, the Board will consult with the affected depository institution as well as the affected Reserve Banks, as the decision could have a significant impact on the depository institution's operations. On a related point, two commenters suggested that the Board clarify that a depository institution may request a location determination. The Board had always intended that a location determination would involve consideration of the views of, and in many cases would be made at the initiation of, the affected institution. The Board has modified the final regulatory language to provide that the Board could make a location determination if it believes such a determination is necessary to enable the institution operate efficiently. The final amendments also provide that the Board

will consult with the affected institution, as well as the relevant Reserve Banks, before making a location determination.

Limited relocations. One commenter suggested that Board should avoid "forum-shopping" by limiting the number of times a bank may change its designated location and by allowing relocations only when undertaken in good faith and on a showing of good cause. As frequent relocations would probably not allow the Board and the Reserve Banks to perform their functions efficiently and effectively, the Board does not expect to allow frequent relocations for a single institution.

Multiple Federal Reserve memberships. One commenter stated that, should the Board consider accommodating interstate banking and branching by allowing banks to become members of two or more Reserve Banks, such a proposal would require careful analysis, further public comment, and perhaps a legislative change. The Board is not at this time considering allowing multiple Federal Reserve memberships for a single bank.

Pass-through provisions. One commenter encouraged the Board to consider additional amendments to Regulation D's pass-through provisions related to member banks and out-of-district correspondents. The Board is in the process of

reviewing the pass-through provisions in light of the Reserve Banks' single-account structure.

Obtaining payments services from other Reserve Banks. Two commenters asked what effect, if any, the proposed amendments would have on the ability of a depository institution to obtain payments and other financial services from a Reserve Bank other than the Reserve Bank at which it holds an account. The Board has proposed amendments to Regulation J (12 CFR part 210), governing the collection and return of checks through Federal Reserve Banks, that would allow an institution to use the check collection services of any Reserve Bank, regardless of where the institution maintains an account (62 FR 27547, May 20, 1997). The Reserve Banks are currently revising their operating circulars to provide institutions with similar flexibility for all Federal Reserve services. These amendments to Regulations D and I, therefore, would not affect the ability of an institution to obtain services from any Reserve Bank.

One of these commenters also asked whether an institution's account relationship and supervisory relationship could be with different Reserve Banks. Absent unusual circumstances, the Board expects that the most efficient and effective administration of Federal Reserve functions generally would require the

account and supervisory functions for a particular depository institution to be located at a single Reserve Bank.

U.S. branches and agencies of foreign banks; Edge and agreement corporations. The Board received four comments on the treatment of U.S. branches and agencies of foreign banks and Edge and agreement corporations under the proposed amendments to Regulation D. All four commenters believed that it would be logical to determine the location of these entities in the same manner as for domestic institutions. The commenters also raised questions related to the number of Federal Reserve accounts that a foreign bank family (or Edge or agreement corporation family) should maintain. The Board is currently reviewing the appropriate treatment for accounts of these entities for reserve purposes.

Effective date

The effective date of the amendments to Regulations D and I is October 1, 1997. This will allow institutions to request location determinations three months in advance of the single account implementation date. Although the Board may make determinations during this three-month period, these determinations generally would not be effective until January 2, 1998.

Delegation of authority

In conjunction with the final amendments discussed above, the Board is also amending its Rules Regarding the Delegation of Authority (12 CFR part 265) to provide that the Secretary of the Board may determine an institution's location under Regulation D or Regulation I if the relevant Federal Reserve Banks and the institution agree on the specific Reserve Bank in which the institution should hold stock or with which the institution should maintain a reserve account, and the agreed-upon location does not raise any significant policy issues. See Docket R-0973, elsewhere in today's Federal Register.

Final Regulatory Flexibility Analysis

Two of the three requirements of a final regulatory flexibility analysis (5 U.S.C. 604), (1) a succinct statement of the need for and the objectives of the rule and (2) a summary of the issues raised by the public comments, the agency's assessment of the issues, and a statement of the changes made in the final rule in response to the comments, are discussed above. The third requirement of a final regulatory flexibility analysis is a description of significant alternatives to the rule that would minimize the rule's economic impact on small entities and reasons why the alternatives were rejected.

The final amendments will apply to all depository institutions, regardless of size, and represent relatively minor changes to the existing rules. The amendments should not have a negative economic impact on small institutions, and, therefore, there were no significant alternatives that would have minimized the economic impact on those institutions. The amendments will clarify the location of an institution for Federal Reserve membership and reserve account maintenance purposes and, in some cases, could reduce economic burden on affected institutions by allowing them to establish that location more conveniently.

List of Subjects

12 CFR Part 204

Banks, banking, Federal Reserve System, Reporting and recordkeeping requirements.

12 CFR Part 209

Banks, banking, Federal Reserve System, Reporting and recordkeeping requirements, Securities.

For the reasons set out in the preamble, 12 CFR parts 204 and 209 are amended as set forth below.

PART 204 -- RESERVE REQUIREMENTS OF DEPOSITORY INSTITUTIONS (REGULATION D)

1. The authority citation for part 204 continues to read as follows:

Authority: 12 U.S.C. 248(a), 248(c), 371a, 461, 601, 611, and 3105.

2. In § 204.3, paragraph (b) is revised to read as follows:

§ 204.3 Computation and maintenance.

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(b) Form and location of reserves. (1) A depository institution, a U.S. branch or agency of a foreign bank, and an Edge or agreement corporation shall hold reserves in the form of vault cash, a balance maintained directly with the Federal Reserve Bank in the Federal Reserve District in which it is located, or a pass-through account. Reserves held in the form of a pass-through account shall be considered to be a balance maintained with a Federal Reserve Bank.

(2) (i) For purposes of this section, a depository institution is located in the Federal Reserve District that contains the location specified in the institution's charter or organizing certificate, or, if no such location is specified, the location of its head office, unless otherwise determined by the Board under paragraph (b)(2)(ii) of this section.

(ii) If the location specified in paragraph (b)(2)(i) of this section, in the Board's judgment, is ambiguous, would impede the ability of the Board or the Federal Reserve Banks to perform their functions under the Federal Reserve Act, or

would impede the ability of the institution to operate efficiently, the Board will determine the Federal Reserve District in which the institution is located, after consultation with the institution and the relevant Federal Reserve Banks. The relevant Federal Reserve Banks are the Federal Reserve Bank whose District contains the location specified in paragraph (b)(2)(i) of this section and the Federal Reserve Bank in whose District the institution is proposed to be located. In making this determination, the Board will consider any applicable laws, the business needs of the institution, the location of the institution's head office, the locations where the institution performs its business, and the locations that would allow the institution, the Board, and the Federal Reserve Banks to perform their functions efficiently and effectively.

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**PART 209 -- ISSUE AND CANCELLATION OF CAPITAL STOCK OF
FEDERAL RESERVE BANKS (REGULATION I)**

3. The authority citation for part 209 continues to read as follows:

Authority: 12 U.S.C. 248, 321-338, 486, 1814, 1816.

4. A new § 209.15 is added to read as follows:

§ 209.15 Location of bank.

(a) General rule. For purposes of this part, a national bank or a state bank is located in the Federal Reserve District that contains the location specified in the bank's charter or organizing certificate, or, if no such location is specified, the location of its head office, unless otherwise determined by the Board under paragraph (b) of this section.

(b) Board determination. If the location of a bank as specified in paragraph (a) of this section, in the Board's judgment, is ambiguous, would impede the ability of the Board or the Federal Reserve Banks to perform their functions under the Federal Reserve Act, or would impede the ability of the bank to operate efficiently, the Board will determine the Federal Reserve District in which the bank is located, after consultation with the bank and the relevant Federal Reserve Banks. The relevant Federal Reserve Banks are the Federal Reserve Bank whose District contains the location specified in the paragraph (a) of this section and the Federal Reserve Bank in whose District the bank is proposed to be located. In making this determination, the Board will consider any applicable laws, the business needs of the bank, the location of the bank's head office, the locations where the bank performs its business, and the locations that would allow the bank, the Board, and the Federal Reserve Banks to perform their functions efficiently and effectively.

By order of the Board of Governors of the Federal Reserve System,

June 23, 1997.

/signed/

William W. Wiles,
Secretary of the Board.

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