Regulation H
Section 109 of the Riegle–Neal Interstate Banking and Branching Efficiency Act

Background
The Riegle–Neal Interstate Banking and Branching Efficiency Act of 1994 (Interstate Act) allows banks to branch across state lines. Section 109 of the act, however, prohibits a bank from establishing or acquiring a branch or branches outside its home state, pursuant to the act, primarily for the purpose of deposit production. Congress enacted section 109 to ensure that interstate branches would not take deposits from a community without the bank’s reasonably helping to meet the credit needs of that community. Interagency regulations implementing section 109 became effective in October 1997. The Board’s rules implementing the provision for state member banks are located in section 208.7 of Regulation H, Membership of State Banking Institutions in the Federal Reserve System.

Section 106 of the Gramm–Leach–Bliley Act of 1999 (GLBA) expanded the coverage of section 109 by changing the definition of an “interstate branch.” As a result, section 109 also applies to any bank or branch of a bank controlled by an out-of-state bank holding company. Interagency regulations implementing this amendment became effective October 1, 2002.

The language of section 109 and its legislative history make clear that section 109 is to be administered without imposing additional regulatory burden on banks. Consequently, the Board’s regulation does not impose additional data-reporting requirements or require banks to produce, or assist in producing, relevant data.

Coverage
Section 109 applies to any bank that has covered interstate branches. (Examples of covered interstate branches follow the examination checklist at the end of this chapter.)

Definitions
Covered Interstate Branch
A covered interstate branch is
• Any branch of a bank; any federal branch of a foreign bank; and any uninsured or insured branch of a foreign bank licensed by a state that
  – Is established or acquired outside the bank’s home state pursuant to the interstate branching authority granted by the Interstate Act or

by any amendment made by the Interstate Act to any other provision of law or
• Could not have been established or acquired outside the bank’s home state but for the establishment or acquisition of a branch described immediately above and
• Any bank or branch of a bank controlled by an out-of-state bank holding company.

Home State
Home state is defined as follows:
• For state banks, the state that chartered the bank
• For national banks, the state in which the main office of the bank is located
• For bank holding companies, the state in which the total deposits of all banking subsidiaries of the company are the largest on the later of
  – July 1, 1966, or
  – The date on which the company becomes a holding company under the Bank Holding Company Act
• For foreign banks,
  – For purposes of determining whether a U.S. branch of a foreign bank is a covered interstate branch, the home state of the foreign bank as determined in accordance with 12 USC 3103(c) and section 211.22 of the Board’s regulations (12 CFR 211.22) and
  – For purposes of determining whether a branch of a U.S. bank controlled by a foreign bank is a covered interstate branch, the state in which the total deposits of all banking subsidiaries of the foreign bank are the largest on the later of
    – July 1, 1966, or
    – The date on which the foreign bank becomes a bank holding company under the Bank Holding Company Act

Host State
Host state means a state in which a covered interstate branch is established or acquired.

Host State Loan-to-Deposit Ratio
The host state loan-to-deposit ratio relates to all banks that have that state as their home state and
is the ratio of those banks’ total loans in the host state to their total deposits from the host state.

Out-of-State Bank Holding Company
An out-of-state bank holding company is, with respect to any state, a bank holding company whose home state is another state.

Statewide Loan-to-Deposit Ratio
The statewide loan-to-deposit ratio relates to an individual bank and is the ratio of the bank’s loans to its deposits in a particular state in which it has one or more covered interstate branches.

The Two-Step Test
Beginning no earlier than one year after a covered interstate branch is acquired by or established as a state member bank, the Board must determine whether a bank is complying with the provisions of section 109. Section 109 provides a two-step test for determining compliance with the prohibition against interstate deposit-production offices:

1. Compare loan-to-deposit ratios—The first step is to conduct a loan-to-deposit (LTD) ratio test to measure the lending and deposit activities of a bank’s covered interstate branches and then compare the bank’s statewide LTD ratio with the host state LTD ratio. If the bank’s statewide LTD ratio is at least one-half of the relevant host state LTD ratio, the bank passes the section 109 evaluation and no further review is required. Host state ratios are prepared annually by the Board and are made public in press releases available on the Board’s public web site under the title “Banking agencies issue host state loan-to-deposit ratios.”

2. Determine whether the bank is meeting credit needs—The second step, necessary if a bank fails the LTD ratio test or the LTD ratio cannot be calculated because data are not sufficient or are not reasonably available, is to determine whether the bank is reasonably helping to meet the credit needs of the communities served by the bank in the host state. This step requires the examiner to review the activities of the bank, such as its lending activity and its performance under the CRA. Banks may provide the examiner with any relevant information, including loan data, if a credit-needs determination is conducted.

Although section 109 specifically requires the examiner to consider a bank’s CRA rating when making a credit-needs determination, the bank’s CRA rating should not be the only factor considered. However, it is expected that banks rated “satisfactory” or better on CRA will receive a favorable credit-needs determination. Banks rated lower than “satisfactory” on CRA may receive an adverse credit-needs determination unless circumstances are mitigated by the other factors enumerated in section 109. To ensure consistency, a bank’s compliance with section 109 generally should be reviewed in conjunction with the evaluation of its CRA performance.

For institutions designated as wholesale or limited purpose banks, the credit-needs determination should consider the bank’s performance using the appropriate CRA performance test provided in the CRA regulations. For banks not subject to CRA, including certain special-purpose banks and uninsured branches of foreign banks, the CRA regulations should be used only as a guideline when making a credit-needs determination. Section 109 does not oblige such banks to have a record of performance under the CRA or require them to pass any CRA performance tests.

Enforcement and Sanctions
Before a bank may be sanctioned under section 109, the examiner must demonstrate that the bank failed the LTD ratio test and failed to reasonably help meet the credit needs of the communities in the host state served by the bank. Because the bank must fail both the LTD ratio test and the credit-needs determination to be in non-compliance with section 109, the examiner has an obligation to apply the LTD ratio test before seeking sanctions, regardless of the regulatory burden imposed. Thus, if a bank receives an adverse credit-needs determination, the LTD ratio test must be applied even if the data necessary to calculate the appropriate ratio are not readily available. Consequently, the examiner is required to obtain the necessary data to calculate the bank’s statewide LTD ratio before sanctions are imposed.

If a bank fails both steps of the section 109 evaluation, sanctions may be imposed, as specified in the statute:

- Ordering the closing of the interstate branch in the host state and
- Prohibiting the bank from opening a new branch in the host state

Sanctions may not be warranted, however, if the bank provides reasonable assurances, to the satisfaction of the Board, that it has an acceptable

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1. A special-purpose bank that does not provide commercial or retail banking services by granting credit to the public in the ordinary course of business is not evaluated for CRA performance. Likewise, a branch of a foreign bank, unless the branch is insured or resulted from an acquisition as described in the International Banking Act, 12 USC 3101 et seq., is not evaluated for CRA performance.
plan that will reasonably help meet the credit needs of the communities served, or to be served. Federal Reserve examiners should consult with Reserve Bank management and the Board before discussing possible sanctions with any bank. Before sanctions are imposed, the Reserve Bank should also consult with state banking authorities.
EXAMINATION OBJECTIVES

- To ensure that a bank is not operating a covered interstate branch, as defined, primarily for the purpose of deposit production, by determining if the bank meets
  - The loan-to-deposit (LTD) ratio test or
  - The credit-needs determination requirements of section 109 of the Interstate Act

EXAMINATION PROCEDURES

(Examples of covered interstate branches follow the examination checklist at the end of this chapter.)

A. Identification of Covered Interstate Branches

1. Banks controlled by an out-of-state bank holding company
   (a) Determine if the bank is controlled by an out-of-state bank holding company by identifying the home state of the bank and the home state of the bank holding company. To determine the home state of a bank, refer to the definition. To determine the home state of a bank holding company, refer to home state data available from the Board and confirm the home state with bank management.
   (b) If the bank is not controlled by a bank holding company, or if the home state of the bank holding company is the same state as the home state of the bank, the bank does not have any covered interstate branches under examination procedure 1. Go to procedure 2.
   (c) If the home state of the bank holding company is not the same as the home state of the bank, the bank meets the definition of a covered interstate branch and is subject to section 109. Go to procedures 2 and 3.

2. Banks with interstate branches
   Determine if the bank has any branches that were established or acquired pursuant to the Interstate Act in states other than the bank’s home state. If it does, the bank has a covered interstate branch. Go to procedure 3. If the bank has no covered interstate branches under procedures 1 and 2, the bank is not subject to section 109, and no further review is necessary.

3. One-year rule
   For the covered interstate branches identified in procedure 1 or 2, determine if any have been covered interstate branches for one year or more. Note that if any of a bank’s covered interstate branches within a particular state have been covered interstate branches for one year or more, then all of the bank’s covered interstate branches within that state are subject to review. If any branch has been a covered interstate branch for one year or more, go to procedure 4. If not, no further review is necessary at this time.

B. Assessment of Compliance with the LTD Ratio Test

4. For a covered interstate branch subject to section 109, determine if the bank has sufficient data to calculate a statewide LTD ratio for each host state. (The bank is not required to provide this information or to assist in providing this information.) For states for which the bank has sufficient data, go to procedure 5. For states for which the bank does not have sufficient data, go to procedure 6.

5. For each host state for which the bank can provide loan and deposit data, calculate and compare the bank’s statewide LTD ratio with the applicable host state LTD ratio provided by the Board. If the bank’s statewide LTD ratio is one-half or greater than one-half of the relevant host state LTD ratio, the bank passes the LTD ratio test and the section 109 evaluation in that state, and no further review is necessary. If the bank’s statewide LTD ratio is less than one-half of the host state LTD ratio in that state, the bank fails the LTD ratio test. Go to procedure 6.

C. Credit-Needs Determination

6. For each host state identified in procedure 4 or 5, determine whether the bank is reasonably helping to meet the credit needs of communities served by the bank in the host state. When making this determination, consider all of the following:
   (a) Whether the covered interstate branches were formerly part of a failed or failing depository institution
   (b) Whether the covered interstate branches were acquired under circumstances in which there was a low LTD ratio because of the
nature of the acquired institution’s business or loan portfolio

(c) Whether the covered interstate branches have a higher concentration of commercial or credit card lending, trust services, or other specialized activities, including the extent to which the covered interstate branches accept deposits in the host state

(d) The most recent ratings (overall rating, multistate MSA rating, and state ratings) received by the bank under the Community Reinvestment Act (CRA)

(e) Economic conditions, including the level of loan demand, within the communities served by the covered interstate branches

(f) The safe and sound operation and condition of the bank

(g) The CRA regulation, examination procedures, and interpretations of the regulation

If the bank passes the credit-needs determination test, it is in compliance with section 109, and no further review is necessary. If the bank fails the credit-needs determination test but a LTD ratio test has not been conducted, go to procedure 7. If the bank fails the credit-needs determination test and has failed the LTD ratio test, the bank is in noncompliance with section 109. Go to procedure 8.

D. Determination of Whether Sanctions Are Warranted

7. Calculate the bank’s statewide LTD ratio for each host state in which the bank failed the credit-needs determination test. The data used to calculate these ratios may be obtained from any reliable source. The bank may, but is not required to, provide the examiner with additional data at any time during the examination. If the bank’s statewide LTD ratio(s) is one-half of or greater than one-half of the host state LTD ratio, the bank is in compliance with section 109 requirements, and no further review is necessary. If the bank’s statewide LTD ratio is less than one-half of the host state LTD ratio, the bank is not in compliance with section 109. Go to procedure 8.

8. Consult with Reserve Bank management and the Board to determine whether sanctions are warranted.
Identify Covered Interstate Branches Subject to Section 109 Evaluation

1. Does the bank have any covered interstate branches? Determine
   (a) If the bank has established or acquired any branches outside the bank’s home state pursuant to the interstate branching authority granted by the Riegle–Neal Interstate Banking and Branching Efficiency Act of 1994 or
   Yes  No
   (b) Whether the bank, including a bank consisting of only a main office, is controlled by an out-of-state bank holding company as defined in section 2(o)(7) of the Bank Holding Company Act of 1956
   Yes  No

   Note: If the answer to both (a) and (b) is “no,” no further review is necessary.

2. Have any covered interstate branches been covered interstate branches for one year or more? If any of a bank’s covered interstate branches within a particular state have been covered interstate branches for one year or more, all the bank’s covered interstate branches within that state are subject to review.
   Yes  No

   Note: If the answer is “no,” no further review is necessary.

Assess Compliance with the Loan-to-Deposit (LTD) Ratio Test

3. For covered interstate branches subject to section 109, does the bank have sufficient data to calculate a statewide LTD ratio(s) for each respective host state?
   Yes  No

   Note: For each host state for which the answer is “no,” proceed to checklist item 5.

4. For each host state in which a covered interstate branch exists, calculate the bank’s statewide LTD ratio. Is the statewide LTD ratio equal to or greater than one-half of the host state LTD ratio?
   Yes  No

   Note: For each host state for which the answer is “yes,” the bank is in compliance with section 109, and no further review is necessary. For each host state for which the answer is “no,” proceed to checklist item 5.

Perform Credit-Needs Determination Test

5. For each host state identified in checklist item 3 or 4, is the bank reasonably helping to meet the credit needs of the communities served by the bank in the host state?
   Yes  No

   When making this determination, consider the following:
   • Whether the covered interstate branches were formerly part of a failed or failing depository institution
   • Whether the covered interstate branches were acquired under circumstances in which there was a low LTD ratio because of the nature of the acquired institution’s business or loan portfolio
   • Whether the covered interstate branches have a higher concentration of commercial or credit card lending, trust services, or other specialized activities, including the extent to which the covered interstate branches accept deposits in the host state
Section 109: Examination Checklist

- The most recent ratings (overall rating, multistate MSA rating, and state ratings) received by the bank under the Community Reinvestment Act (CRA)
- Economic conditions, including the level of loan demand, within the communities served by the covered interstate branches
- The safe and sound operation and condition of the bank
- The CRA regulation, examination procedures, and interpretations

Note: If the bank passes the credit-needs determination test, the bank complies with section 109, and no further review is necessary. If the bank fails the credit-needs determination test but the LTD ratio test has not yet been conducted, go to checklist item 6. If the bank fails the credit-needs determination test and has failed the LTD ratio test, go to item 7.

**Determine if Sanctions Are Warranted**

6. Calculate the statewide LTD ratio for each host state for which the bank failed the credit-needs determination test. Is this ratio equal to or greater than one-half of the host state LTD ratio?  
   Yes  No

Note: If the answer is “yes,” the bank is in compliance with section 109, and no further review is necessary. If the answer is “no,” the bank is in noncompliance with section 109 (go to checklist item 7).

7. After consultation with Reserve Bank management and the Board, are sanctions warranted?  
   Yes  No
Regulation H–Section 109
Examples of Covered Interstate Branches

Bank with Branches outside Its Home State

Bank A is an interstate bank with branches in Pennsylvania that were established or acquired under the Interstate Act. Bank A’s home state is New York and its host state is Pennsylvania. The Pennsylvania branches are covered interstate branches subject to the section 109 review. Bank A’s statewide loan-to-deposit (LTD) ratio in Pennsylvania is compared with the host state LTD ratio for Pennsylvania.

The section 109 test is conducted at the same time the bank’s CRA examination is conducted.

Bank Consisting of Only a Main Office and Controlled by an Out-of-State Bank Holding Company

Banks B and C are controlled by a bank holding company whose home state is New York. Bank B is an intrastate bank and is not subject to the section 109 review.

Bank C’s home state is Connecticut; it is subject to the section 109 review because it is controlled by an out-of-state bank holding company whose home state is New York. Bank C’s statewide LTD ratio in Connecticut is compared with the host state LTD ratio for Connecticut.

The section 109 test is conducted at the same time the bank’s CRA examination is conducted.

Note: Bold type indicates that the bank or branch is subject to the section 109 review.
Covered Interstate Branches
under a Multitiered Bank Holding Company Structure

This example illustrates the need to look to the top-tier bank holding company when determining whether to conduct the section 109 review. Banks J, K, L, and M are controlled by a top-tier holding company whose home state is New York.

Out-of-state bank holding company

Banks J and M are subject to section 109 reviews because an out-of-state top-tier bank holding company controls both of them. Bank J’s home state is Pennsylvania; its statewide LTD ratio in Pennsylvania is compared with the host state LTD ratio for Pennsylvania. Bank M’s home state is Connecticut; its statewide LTD ratio in Connecticut is compared with the host state LTD ratio for Connecticut.

Out-of-state branches

Bank M’s branches in New York also are subject to the section 109 review, because Bank M is an interstate bank. Bank M’s home state is Connecticut; its statewide LTD ratio in New York is compared with the host state LTD ratio for New York.

Bank L’s branches in Pennsylvania also are subject to the section 109 review because Bank L is an interstate bank. Bank L’s home state is New York; its statewide LTD ratio in Pennsylvania is compared with the host state LTD ratio for Pennsylvania.

Not subject to 109 review

Bank K is not subject to review for section 109 compliance because an out-of-state bank holding company does not control it and it does not have interstate branches.

The section 109 test is conducted at the same time the bank’s CRA examination is conducted.

Note: Bold type indicates that the bank or branch is subject to the section 109 review.