

Prohibition Against Use of Interstate Branches Primarily for Deposit Production¹

Introduction

The Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation (“the agencies”), jointly issued a final rule, effective October 10, 1997, that adopted uniform regulations² implementing section 109 of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (IBBEA).

IBBEA allows banks to branch across state lines. Section 109, however, prohibits any bank from establishing or acquiring a branch or branches outside of its home State, pursuant to IBBEA, 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 reasonably helping to meet the credit needs of that community.

Subsequently, section 106 of the Gramm-Leach-Bliley Act of 1999 (GLBA) amended section 109 by changing the definition of an “interstate branch” to include any 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 the agencies are to administer section 109 without imposing additional regulatory burden on banks. Consequently, the agencies’ regulations do not impose additional data reporting requirements nor do they require a bank 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 can be found at the end of the Examination Procedures in this section.

Definitions

“Covered Interstate Branch”

1. Any branch of a national bank, a State member bank, or a State nonmember bank, and any Federal branch of a foreign bank, or any uninsured or insured branch of a foreign bank licensed by a State, that:
 - (i) is established or acquired outside the bank’s home State pursuant to the interstatebranching authority granted by IBBEA or by any amendment made by IBBEA to any other provision of law; or

- (ii) could not have been established or acquired outside of the bank’s home State but for the establishment or acquisition of a branch described in (i) and

2. any bank or branch of a bank controlled by an out-of-State bank holding company.

“Home State”

1. For State banks, home State means the State that chartered the bank.
2. With respect to a national bank, home State means the State in which the main office of the bank is located.
3. With respect to a bank holding company, home State means the State in which the total deposits of all banking subsidiaries of such company are the largest on the later of:
 - (i) July 1, 1966; or
 - (ii) the date on which the company becomes a holding company under the Bank Holding Company Act.
4. With respect to a foreign bank, home State means:
 - (i) 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 Federal Reserve Board’s Regulations (12 CFR §211.22), Section 28.11(o)) of the OCC’s regulations (12 CFR §28.11(o), and Section 347.202(j) of the FDIC’s regulations (12 CFR §347.202(j)); and
 - (ii) 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 such foreign bank are the largest on the later of:
 - (a) July 1, 1966; or
 - (b) the date on which the foreign bank becomes a bank holding company under the Bank Holding Company Act.

“Host State” – means a State in which a covered interstate branch is established or acquired.

“Host State Loan-to-Deposit Ratio” – is the ratio of total loans in the host State to total deposits from the host State for all banks that have that State as their home State.

“Out-of-State Bank Holding Company” – means, with respect to any State, a bank holding company whose home State is another State.

“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 where 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 or established, the agency will determine

¹ This section fully incorporates the examination procedures issued under DSC RD Memo 03-006: Interstate Banking Examination Procedures for Section 109 of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994.

² See 12 CFR 25, 12 CFR 208, and 12 CFR 369.

X. Other – Deposit Production Offices

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. Loan-to-deposit ratio. The first step involves a loan-to-deposit (LTD) ratio screen, which is designed to measure the lending and deposit activities of covered interstate branches. The LTD ratio screen compares the bank's statewide LTD ratio to 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, and made public, by the agencies annually. For the most recent ratios, *see* OCC bulletins, FDIC Financial Institution Letters, or FRB Press Releases.
2. Credit needs determination. The second step is a credit needs determination that is conducted if a bank fails the LTD ratio screen or if the LTD ratio cannot be calculated due to insufficient data or due to data that are not reasonably available. This step requires the examiner to review the activities of the bank, such as its lending activity and performance under the CRA, in order to determine whether the bank is reasonably helping to meet the credit needs of the communities served by the bank in the host State. Banks may provide the examiner with any relevant information including loan data, if a credit needs determination is performed.

Although Section 109 specifically requires the examiner to consider a bank's CRA rating when making a credit needs determination, a bank's CRA rating should not be the only factor considered. However, since most of the other factors (*see* procedure for Credit Needs Determination) are taken into account as part of a bank's performance context under CRA, it is expected that banks with a satisfactory or better CRA rating will receive a favorable credit needs determination. Banks with a less than satisfactory CRA rating may receive an adverse credit needs determination unless mitigated by the other factors enumerated in section 109. To ensure consistency, compliance with Section 109 generally should be reviewed in conjunction with the evaluation of a bank's CRA performance.

With respect to institutions designated as wholesale or limited purpose banks, a credit needs determination should consider a 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,³ the examiner should use the CRA regulations only as a guideline when making a credit needs determination for such institutions. Section 109 does not

obligate the institution to have a record of performance under the CRA nor does it require the institution to pass any CRA performance tests.

Enforcement and Sanctions

Before a bank can be sanctioned under section 109, the appropriate agency is required to demonstrate that the bank failed to comply with the LTD ratio screen and failed to reasonably help meet the credit needs of the communities served by the bank in the host State. Since the bank must fail both the LTD ratio screen and the credit needs determination in order to be in noncompliance with Section 109, the agencies have an obligation to apply the LTD ratio screen before seeking sanctions, regardless of the regulatory burden imposed. Thus, if a bank receives an adverse credit needs determination, the LTD ratio screen must be applied even if the data necessary to calculate the appropriate ratio are not readily available. Consequently, the agencies are 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, the statute outlines sanctions that the appropriate agency can impose. The sanctions are:

- (i) ordering the closing of the interstate branch in the host State; and
- (ii) prohibiting the bank from opening a new branch in the host State.

Sanctions, however, may not be warranted if a bank provides reasonable assurances to the satisfaction of the appropriate agency that it has an acceptable plan that will reasonably help to meet the credit needs of the communities served, or to be served. An examiner should consult with the RO before discussing possible sanctions with any bank. Also, before sanctions are imposed, the agencies stated in the preamble to the final 1997 regulation that they intend to consult with State banking authorities.

Examination Objective

To ensure that a bank is not operating a covered interstate branch(es), as defined, primarily for the purpose of deposit production, by determining if the bank meets (i) the loan-to-deposit (LTD) ratio screen, or (ii) the credit needs determination requirements of section 109 of IBBEA.

Examination Procedures

Examples of covered interstate branches can be found at the end of this section.

Identification of Covered Interstate Branches

1. *Banks controlled by an out-of-State bank holding company.*

³ A special purpose bank that does not perform commercial or retail banking services by granting credit to the public in the ordinary course of business is not evaluated for CRA performance by the agencies. In addition, branches of a foreign bank, unless the branches are insured or resulted from an acquisition as described in the International Banking Act, 12 USC 3101 et seq., are not evaluated for CRA performance by the agencies.