



Compliance Corner

FEDERAL RESERVE BANK OF PHILADELPHIA

Prepared for institutions supervised by the Consumer Compliance & CRA Unit

The Prohibition Against the Use of Interstate Branches Primarily for Deposit Production

The Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation jointly issued a final rule, effective October 10, 1997, that adopted uniform regulations implementing section 109 of the *Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994* (Interstate Act).¹

The Interstate Act 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 the Interstate 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 reasonably

helping to meet the credit needs of that community.

Subsequently, section 106 of the *Gramm-Leach-Bliley Act of 1999* 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, 2002.²

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

¹The Joint Final Rule *Prohibition Against Use of Interstate Branches Primarily for Deposit Production* is available on the Board of Governors web site at <www.federalreserve.gov/boarddocs/press/boardacts/1997/19970905/R-0962.pdf>.

²The revised Joint Final Rule *Prohibition Against Use of Interstate Branches Primarily for Deposit Production* is available on the Board of Governors web site at <www.federalreserve.gov/boarddocs/press/bcreg/2002/20020605/attachment.pdf>.

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bank to produce, or assist in producing, relevant data.

The Two-Step Test

Beginning no earlier than one year after a covered interstate branch is acquired or established, the agency will 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. **Loan-to-deposit ratio.** The first step involves a loan-to-deposit (LTD) ratio, which is designed to measure the lending and deposit activities of covered interstate branches. The LTD ratio compares the bank's statewide LTD ratio in the host state 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.

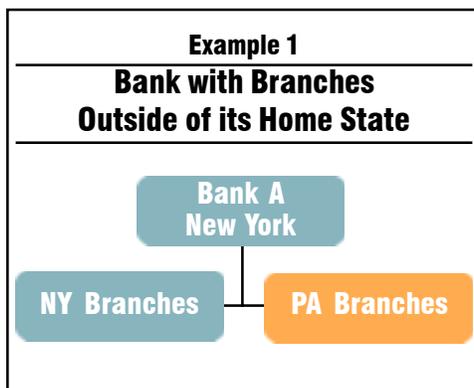
2. **Credit needs determination.** The second step—a credit needs determination—is conducted if a bank fails the LTD ratio test or if the LTD ratio cannot be calculated due to insufficient data or data that is not reasonably available. This step requires the examiner to review the activities of the bank, such as its lending activity and performance under CRA, 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 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 should be reviewed in conjunction with the evaluation of a bank's CRA performance.

Practical Examples of Section 109 Application

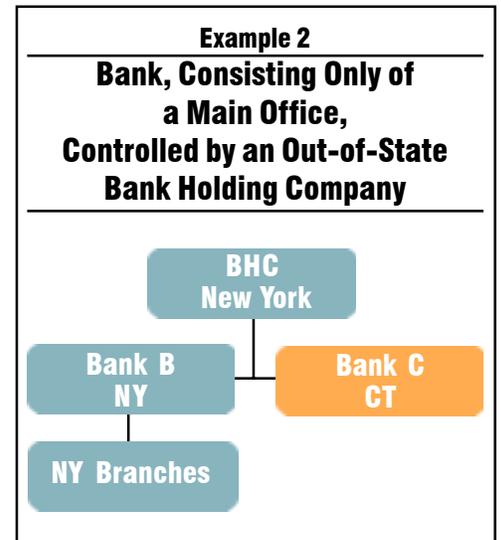
The following charts contain examples of interstate branches that would be subject to section 109.³



In Example 1, Bank A is an interstate bank with branches in Pennsylvania

³ The banks and/or branches in the following charts that appear in orange are subject to section 109 review.

established or acquired under the Interstate Act. Bank A's home state is New York and its host state for the Pennsylvania branches 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 will be compared to the host state LTD ratio for Pennsylvania.



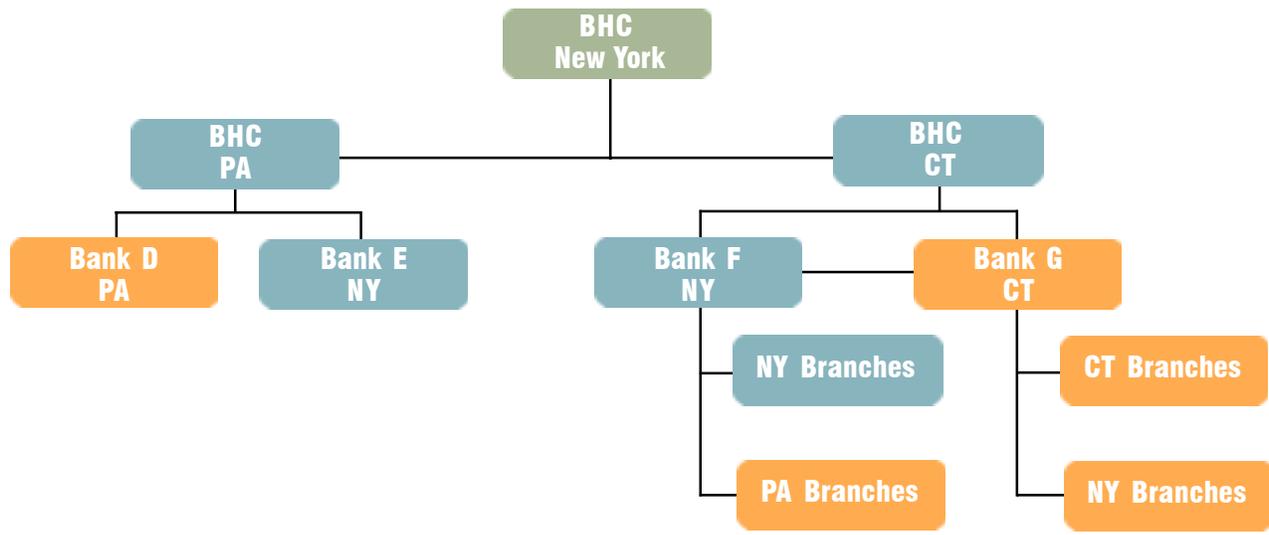
In Example 2, Banks B and C are both controlled by a BHC whose home state is New York. Bank B is an intrastate bank and is not subject to the section 109 review.

Bank C's home state is Connecticut and it is subject to the section 109 review because it is controlled by an out-of-state BHC whose home state is New York. Bank C's statewide LTD ratio in Connecticut will be compared to the host state LTD ratio for Connecticut.

Example 3 illustrates the requirement to look to the top tier BHC when determining whether to conduct a section 109 review. Banks D, E, F, and G are all controlled by a top-tier BHC whose home state is New York.

Example 3

Covered Interstate Branches Under a Multi-Tiered Bank Holding Company Structure



Out-of-State BHC. Banks D and G are subject to section 109 reviews because an out-of-state top tier BHC controls both of them. Bank D's home state is Pennsylvania; its statewide LTD ratio in Pennsylvania will be compared to the host state LTD for Pennsylvania. Bank G's home state is Connecticut; its statewide LTD ratio in Connecticut will be compared to the host state LTD ratio for Connecticut.

Out-of-State Branches. Bank G's branches in New York also are also subject to the section 109 review because Bank G is an interstate bank.

Bank G's home state is Connecticut; its statewide LTD ratio in New York will be compared to the host state LTD ratio for New York.

Bank F's branches in Pennsylvania are also subject to the section 109 review because Bank F's home state is New York; its statewide LTD ratio in Pennsylvania will be compared to the host state LTD ratio for Pennsylvania.

Not Subject to Section 109 Review. Although Bank E is owned by a BHC headquartered in another state, its top tier BHC is headquartered in the same

state as Bank E. Therefore, Bank E is not subject to review for section 109 compliance because an out-of-state BHC does not control it and it does not have interstate branches.

Please contact your primary regulator with any questions about section 109 of the Interstate Act. If you are supervised by the Federal Reserve Bank of Philadelphia, please contact Constance Wallgren, Consumer Compliance/CRA Examinations Unit Manager (connie.wallgren@phil.frb.org) through the Regulations Assistance Line at (215) 574-6568. ■