



## REGULATORY INTERPRETATION 2012-RI-02

**Subject:** Membership - Determination of Principal Place of Business.

**Issue:** Whether a non-depository institution that is eligible for membership can establish its principal place of business in a particular state based solely on the fact that it has been organized under the laws of that state.

**Conclusion:** The fact that a non-depository institution has been organized under the laws of a particular state is not sufficient, by itself, to establish that state as the institution's principal place of business. For cases in which such an institution applies for membership, the location of its "principal place of business" is largely a question of fact that a Bank should resolve by identifying the location at which the institution actually conducts its principal business operations.

### **Background:**

Section 4(b) of the Federal Home Loan Bank Act (Bank Act), 12 U.S.C. § 1424(b), provides that an institution that is eligible to become a Bank member may become a member only of the Federal Home Loan Bank (Bank) for the district in which the institution maintains its "principal place of business."<sup>1</sup> The Bank Act does not define the term "principal place of business," but the regulations of the Federal Housing Finance Agency (FHFA) provide that, with one exception, an institution's principal place of business is the state in which it "maintains its home office established as such in conformity with the laws under which the institution is organized." The regulations also allow an institution to designate a state other than the one in which it maintains its home office as its principal place of business, provided that: (i) at least 80 percent of the institution's accounting books, records and ledgers are maintained in that state; (ii) a majority of the institution's board of director and board committee meetings are held in that state; and (iii) a majority of the institution's five highest paid officers have their places of employment located in that state. 12 C.F.R. § 1263.18(b), (c).

In the case of federally chartered depository institutions, the determination of an institution's principal place of business is straightforward because such institutions are required to designate their home office in their chartering documents. *See* 12 U.S.C. § 22 (national bank organization certificate must designate city and state from which it will operate); 12 C.F.R. §§ 544.1, 552.3 (federal savings and loan association charters specify the city and state of its home office). The same is typically true for state chartered depository institutions.<sup>2</sup> Thus, a

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<sup>1</sup> That provision further provides that an eligible institution may become a member of a Bank for an adjoining district, but only if such an arrangement is "demanded by convenience" and has been approved by the Director of FHFA.

<sup>2</sup> *See, e.g.,* N.Y. Banking Law §§ 230 and 375 (organization certificate for savings banks and savings and loan associations, respectively, must state location of the principal office); California Financial Code § 502 (every bank

depository institution would ordinarily be deemed to have its principal place of business at the same location as the home office designated in its chartering documents, even if the institution has branch offices in other states and conducts significant business from those other offices.

For non-depository institution members, however, such as insurance companies and community development financial institutions (CDFIs), it is possible that the state laws under which they are organized will not require them to designate or maintain a home office. In such cases, a Bank cannot simply look to the chartering documents to determine the institution's principal place of business, as is contemplated by the above-cited regulatory provision. Instead, although the regulations do not address such situations, a Bank would need to look to other factors, such as the location of the institution's business operations, to determine its principal place of business. Such an approach is unlikely to cause difficulties for institutions that conduct their business operations from locations within the same state that chartered them. It is also possible, however, that some states may allow business entities organized under their the laws to conduct their principal business operations from locations in other states. Such situations do present issues for the Banks because FHFA regulations do not address how a Bank should determine the principal place of business for such institutions.

In recent months, FHFA has received inquiries from several Banks about how to determine the principal place of business of an insurance company or CDFI that is organized under the laws of one state but is not required by those laws to designate a home office or may conduct most or all of its business operations from locations in another Bank district. One Bank has asked that FHFA issue a regulatory interpretation to address these issues, and that FHFA allow a Bank to deem the state of incorporation for a CDFI to be its principal place of business for Bank membership purposes. In that case, the CDFI's bylaws stated that its principal office was to be located in the state of its incorporation, although the CDFI did not in fact maintain a business office in that state.<sup>3</sup>

***Analysis:***

The statutory provision limiting membership to the Bank in whose district an applicant maintains its principal place of business dates to the original Bank Act, which authorized only thrift institutions and insurance companies to become members. At that time, thrift institutions were all state chartered and locally based. They had no interstate operations, and they made up the overwhelming majority of Bank members. Although the thrift and banking industries have changed substantially since 1932 and Congress has expanded the membership base to include commercial banks, credit unions, and CDFIs, Congress has not altered the provision that limits membership to the Bank in whose district the applicant maintains its principal place of business.

FHFA and its predecessor have defined the term "principal place of business" to mean an institution's "home office" or some other location that serves as the center of its business and

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shall maintain a head office in California), § 5401 (organizing permit for savings association must include the proposed location for its office), and § 5654(a) (no savings association shall establish an office other than its head office, as named in its certificate of authority, without approval).

<sup>3</sup> The CDFI maintained its main business office in another state, but a majority of its loans had been made to finance properties that were located in its state of incorporation.

executive operations, as evidenced by the presence at that other location of the institution's accounting books and ledgers, board and committee meetings, and executive officers. In both of those instances, the institution would at least have a physical presence in the particular state, coupled with some level of executive or operational business activities that are conducted from within the state. That would be true even in the case of a depository institution with a home office in one state that has branch offices in other states or whose executive officers may be located at the corporate headquarters of its holding company in another state.

To look solely to the state of incorporation as the determinative factor for membership purposes would effectively allow an institution to designate as its "principal place of business" a state in which it in fact has no places of business: no physical presence, executive presence, or other in-state business activities. Such a result would not be consistent with the requirements of the Bank Act. Accordingly, a Bank cannot rely solely on the state of incorporation for determining whether a particular non-depository institution is eligible for membership, but instead must look to other factors that indicate the location at which the institution actually conducts its principal business operations.

Two factors relating to the CDFI that prompted the request for a regulatory interpretation – a bylaw reference and the location of the CDFI's loans – also are not sufficient to demonstrate that the state of incorporation should be deemed to be its principal place of business. With respect to the bylaws, which recite that the principal office of the CDFI shall be in the state of incorporation, that reference appears not to be required by state law. Therefore, the principal office described in the bylaws could not be deemed to be a home office "established as such in conformity with the laws" of the state of incorporation, as is contemplated by FHFA regulations. More importantly, the bylaw is not consistent with the facts, as the CDFI has no business office in the state of its incorporation. Relying on a bare reference in a CDFI's bylaws to a home office location that does not in fact exist would not be consistent with the concept of a "principal place of business" as used in the Bank Act. In contrast, in the case of insured depository institution members, a Bank may assume that the statutory and regulatory requirement that it name a home office is supported by a chartering and examining authority.

With respect to the location of the CDFI's loans, the request noted that a majority of the existing loans had been made in the state of incorporation, although the institution also made loans in other states throughout the country. The location of a CDFI's existing loans may be a relevant factor, in combination with others, in identifying the location of its principal place of business, but it is not determinative by itself. The location of the loans would confirm that an institution conducts some business in the state, but such a borrower-oriented focus may not be a reliable indicator of the institution's principal place of business because the identity and location of its borrowers may change over time. Moreover, the ordinary-language meaning of "principal place of business" contemplates something beyond the location of an entity's customers, such as a physical presence where the officers and employees conduct the business operations of the enterprise.

Determining the principal place of business for a non-depository institution that has little or no business presence in its state of incorporation is a factual determination that a Bank must make on a case-by-case basis. A Bank should make such determinations based on objective factors that indicate the location at which the institution's predominant business activities take

place. In most cases, a Bank should be able to identify one state in which or from which an insurance company or CDFI applicant actually conducts the majority of its business operations. The membership regulations already employ that approach by allowing a member to designate as its principal place of business the state in which it maintains at least 80 percent of its accounting books and records, conducts the majority of its board and committee meetings, and employs a majority of its five highest paid executive officers. A Bank may use those same factors as *prima facie* evidence of an applicant's principal place of business. A Bank may also rely on other factors that indicate the location from which the institution actually conducts its business.

A Bank that uses such an approach should document the factors on which it has relied in determining the institution's principal place of business, so that they may be reviewed during the examination process. In cases in which a Bank cannot identify an institution's principal place of business, it should consult with FHFA for guidance.

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This Regulatory Interpretation is issued pursuant to 12 C.F.R. § 907.5 and is subject to modification or rescission by the Director of the Federal Housing Finance Agency.