

P-98-10



Office of Thrift Supervision

Department of the Treasury

Chief Counsel

1700 G Street, N.W., Washington, DC 20552 • (202) 906-6251

October 1, 1998

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Re: Authority of Federal Savings Associations to Provide Payroll Processing Services

Dear []:

This responds to your inquiry to the Office of Thrift Supervision (“OTS”) concerning whether [], (the “Association”), may provide payroll processing services on a fee for service basis. The Association would receive information from employers on the salary and hours of their employees, produce checks or create Automated Clearing House (“ACH”) credits for direct deposit, complete payroll tax returns, and direct the employers to make their own tax deposits. The Association would not escrow payroll taxes withheld or accrued for the employers.

You indicate that the Association currently out-sources its own payroll processing. You anticipate that the Association’s payroll processing services would be used mostly by small business employers, only some of whom may be the Association’s loan and deposit customers. You state that the Association would be willing to bring its own payroll processing in-house and open payroll checking accounts for the employers, if necessary.

The payroll processing services you describe are authorized under OTS’s data processing services regulation, § 545.138, subject to restrictions. This regulation permits federal savings associations, on a for-profit basis, to process and transmit data that is “financial, economic, or related to thrift, home financing, or the activities of depository institutions.”¹ As explained below, the preambles to OTS’s proposed and

¹ 12 C.F.R. § 545.138(a), (b)(1) (1998).

final data processing services regulations support that conclusion that payroll data qualifies as “financial” or “economic” data.

In 1982, OTS proposed to revise its then-existing data processing services regulation, § 545.16-1 (“the old rule”).² The preamble indicated that the proposed revision would continue to permit those services that had been permitted under the old rule.³ The old rule authorized a federal savings association to maintain a data processing office to provide “data-processing services” primarily for its own use and to others when “incidental or secondary to meeting its own needs.”⁴ The old rule defined “data-processing services” to be limited to the “maintenance of bookkeeping, accounting, or other records primarily by mechanical or electronic methods.”⁵ While the old rule did not specifically list payroll processing services as authorized, these services were permitted because they are bookkeeping or accounting functions.

The preamble to the proposed rule also indicated that the proposed revision would allow a federal savings association to provide a broader array of data processing services than under the old rule. OTS proposed to allow a federal savings association to process or transmit data that were “financial, economic, or related to thrift, home financing or the activities of depository institutions.”⁶ The preamble explained that federal savings associations could “collect, process, store, analyze, and transmit other sorts of financial and economic data” that were not covered by the old rule, including data pertaining to employment. Even the proposed new standard then could encompass processing payroll data because it is employment-related.⁷

² 47 Fed. Reg. 42,366 (Sept. 27, 1982).

³ 47 Fed. Reg. at 42,368.

⁴ 12 C.F.R. § 545.16-1(a), (b) (1983). See also 47 Fed. Reg. at 42,367.

⁵ 12 C.F.R. § 545.16-1(a) (1983).

⁶ 47 Fed. Reg. at 42,369 (proposed § 545.16-1(b)(1)). Under the proposal, a federal savings association could provide data processing services primarily for its own use, the use of a subsidiary, or the use of another depository institution through a data processing office without the association needing to observe the application and approval procedures for branch offices. Id.

⁷ The preamble further indicated that if type of data was integral to a federal savings association’s own operations, the association could also process that type of data for other depository institutions as a correspondent service. 47 Fed. Reg. at 42,369. A “correspondent service” is a service a federal savings association is authorized to generate in-house for itself in the regular course of business, including electronic data processing, and which it may provide to other financial institutions for a fee. See, e.g., OTS Op. Chief Counsel (Oct. 17, 1995) at 3 (and authorities cited therein); OTS Op. Chief Counsel (May 10, 1995) at 8-9.

The preamble to OTS's 1983 final data processing services regulation promulgating § 545.138 further suggests that payroll data is "financial" or "economic" data.⁸ The preamble characterizes the types of data covered by the standard as that which are "integral to the business operations of associations (including those of a parent or subsidiary), to dealings with borrowers and depositors, and to business relationships with other institutions."⁹ Payroll data fits this characterization. An association needs payroll data on its own employees. Thus, payroll data is integral to and utilized in an association's business operations and, therefore, can properly be characterized as financial or economic.¹⁰

Under the regulation, however, there are restrictions on a federal savings association's authority to provide data processing services to others. One restriction is on the customers an association may serve. If an association provides these services, it must do so "primarily for itself, other depository institutions ..., and persons with whom the Federal savings association has established a loan or deposit relationship."¹¹ An association may also provide data processing services to others, but only to the extent the total services to others "constitute less than one half of the data processing services provided"¹²

Thus, the Association will need to ensure that it provides more than half of its data processing services to itself, other depository institutions, and persons with whom it has a loan or deposit relationship. While the Association may meet this requirement by serving any one or any combination of these entities,¹³ the Association will likely

⁸ 48 Fed. Reg. 7428 (Feb. 22, 1983).

⁹ 48 Fed. Reg. at 7429.

¹⁰ We also note that Federal Reserve Board ("FRB") regulations interpreting the data processing authority of bank holding companies used to contain a similar term: "banking, financial, or related economic data." 12 C.F.R. § 225.4(a)(8) (1982). The FRB interpreted that term to include payroll processing. *Id.*; 67 FRB 447 (May 1981).

Further, the proposed activity is similar to an authorized national bank activity: serving as a "payroll issuer." This activity involves "disbursing to employees of a bank customer payroll funds deposited with the bank by that customer." 12 C.F.R. § 7.1011 (1998).

¹¹ 12 C.F.R. § 545.138(b)(2) (1998).

¹² *Id.*

¹³ The allocation of services among the Association, other depository institutions, and loan and deposit customers does not matter. *See* 48 Fed. Reg. at 7430.

need to take certain steps to meet the requirement such as bringing its own payroll processing in-house and/or opening payroll checking accounts for the employers. You have indicated that the Association is willing to take both of these steps. In addition, the Association must comply with all other restrictions indicated in the regulation.¹⁴

Although the Association is primarily interested in offering payroll processing services directly, you also ask whether the Association may, in the alternative, offer these services through a service corporation. The Association may offer these services through a service corporation, so long as it satisfies the applicable notice or application requirements.¹⁵ OTS regulations provide that a service corporation may engage in any activity that all federal savings associations may conduct directly, except taking deposits.¹⁶ Since, as discussed above, the payroll processing services you describe are authorized for federal savings associations, they are also authorized for service corporations. Moreover, service corporations may provide payroll processing services under the preapproved service corporation authority to conduct "business and professional services" that are "limited to financial documents or financial clients or are generally finance-related."¹⁷ The regulation lists several examples of activities preapproved under this authority including "accounting or internal audit" and "data processing."¹⁸ Payroll processing is an accounting service as well as a data processing service. It is also finance-related and is limited to financial documents. Thus, payroll processing is a preapproved business and professional service activity for service corporations and does not have to be limited to financial clients.¹⁹

¹⁴ The Association must not require borrowers to obtain data processing services from the Association as a condition of obtaining credit. Such a requirement would violate tying restrictions. 12 C.F.R. § 545.138(e) (1998); 48 Fed. Reg. at 7430. Other restrictions pertain to the design and operation of data processing facilities (§ 545.138(b)(3)) and the marketing of excess capacity (§ 545.138(c)). We note that while OTS has proposed to ease the restrictions on data processing services, see 62 Fed. Reg. 51,817, 51,818 (Oct. 3, 1997), no changes have been finalized to date.

¹⁵ 12 C.F.R. § 559.3(e)(2) (1998).

¹⁶ 12 C.F.R. §§ 559.4(a) and 559.3(e)(2)(ii) (1998).

¹⁷ 12 C.F.R. § 559.4(b) (1998).

¹⁸ 12 C.F.R. § 559.4(b)(1) and (6) (1998). See also 12 C.F.R. § 559.4(i) (1998).

¹⁹ The preamble to OTS's final rule promulgating the service corporation regulations clarifies that preapproved business and professional services may be performed "for any person," not just primarily for financial institutions or financial clients, so long as the services are generally finance-related. 61 Fed. Reg. 66,561, 66,565 (Dec. 18, 1996). Thus, one advantage to providing payroll processing services through a service corporation under this authority is freedom from the customer restrictions that apply when the services are performed directly by a federal savings association.

In reaching the foregoing conclusions, we have relied on the factual representations made in your letter and in a subsequent discussion between you and OTS staff. Any material change in facts or circumstances from those described herein could result in a different conclusion.

If you have any questions regarding this matter, please feel free to contact Richard Bennett, Counsel (Banking and Finance), at (202) 906-7409.

Very truly yours,

A handwritten signature in cursive script, appearing to read "Carolyn J. Buck".

Carolyn J. Buck
Chief Counsel

cc: Regional Directors
Regional Counsel