

Memo 1996-8B

TO: All Kansas State Chartered Banks
FROM: W. Newton Male, Bank Commissioner
DATE: June 21, 1996
RE: Leasing of Bank Premises to Third Parties

Note: This memorandum supersedes and replaces the December 13, 1993 departmental memo on leasing of bank space.

This memorandum is designed to provide general guidelines pertaining to leasing of bank premises to third parties, including but not limited to securities marketers, insurance agencies or travel agencies. Sections A and Section B of this memorandum contain provisions which the banks are required to follow in order to remain in compliance with K.S.A. 9-1102. Section C contains suggested practices banks may want to consider. These suggested practices may be tailored to fit a particular bank's own circumstances, and are designed to provide the bank extra protection against unnecessary or unwanted liability.

The overriding concern in any third-party leasing arrangement is to ensure that the lessee conducting business on bank premises maintains a separate existence from the bank/lessor. This separateness must be maintained both in terms of public appearance and financial responsibility. Maintaining this separate nature helps ensure that the bank is not required to defend lawsuits or shoulder liability that may result from the actions of the third party lessee.

This memorandum has been drafted with sensitivity to the broad variation that exists between large metropolitan banks and small community banks with regard to available space, personnel, and service capabilities. For purposes of this memo wholly owned subsidiaries of the bank are not considered third party lessees. Entities which are owned by the holding company of the bank or by insiders of the bank which conduct business operations on bank premises are considered third party lessees.

A. General Terms of Third-Party Lease Agreements.

After the bank's board of directors has determined by a majority vote that a lease agreement should be entered into, the bank must draft a written agreement with the third party. The final lease agreement should be approved by the bank's board of directors. At a minimum, the written agreement should:

1. contain a clause expressly negating the existence of a partnership or joint venture;
2. describe the duties and responsibilities of each party, including a description of permissible activities by the third party on the institution's premises, terms as to the use of the institution's space, personnel, and equipment, and compensation arrangements for personnel of the institution and the third party;

3. require the third party to comply with all terms of the agreement, applicable laws and regulations;
4. authorize the institution and the appropriate banking authority to have access to such records of the third party as are necessary or appropriate to evaluate compliance with the agreement;
5. provide authority for prior approval by the bank's board, or the board's designee, of all advertising of the third party; and
6. require the third party to indemnify the institution against potential liability resulting from actions of the third party.

The agreement may include other items, such as providing for written employment contracts for any personnel who are employees of both the institution and the third party.

B. Leases to Third Parties Conducting Retail Sales of Nondeposit Investment Products.

The need for separation of operations and the potential for customer confusion are most serious when the third party is offering nondeposit investment products such as mutual funds and annuities on bank premises. Sales activities should be designed to minimize customer confusion about the products offered and to safeguard the bank from potential liability. The department has determined that a bank's compliance with the February 15, 1994 Federal Interagency Statement on Retail Sales of Nondeposit Investment Products should adequately relieve any regulatory concerns of this department. The Interagency Statement has been further clarified by the September 12, 1995 Joint Interpretations of the Interagency Statement which likewise is hereby adopted by this department.

Since all federally insured institutions are obligated to comply with the Interagency Statement, adoption by reference of these existing authorities will reduce duplication of regulation and eliminate confusion created by the existence of parallel rules.

C. Additional Considerations.

The following subjects contain some overlap with or resemblance to requirements contained in the Federal Interagency Statement. If the activity being conducted by the third party involves the sale of nondeposit investment products, compliance with all terms in the Interagency Statement is required. However, the subjects in this section are additional protective measures the bank should consider in any type of third party lease arrangement. They are intended as general guidelines. Implementation of these guidelines is recommended but not required by the department.

1. *Work Space*

When possible the location of the third party lessee's operation should be physically separated from the bank's operations. It is recognized that physical separation of work space is not possible in many small banks. In those circumstances, it becomes especially important to delineate in any way possible, between banking services and services provided by the lessee. One way to accomplish that goal is to ensure that nonbank operations are not being conducted at a bank teller's window where retail deposits are taken, or at a similar point of service. It has also been suggested by bankers that the following type of document be signed by customers receiving services from the third party, regardless of the customer's relationship with the bank, and placed in the third party's files:

I, (customer's name) have been advised that (third party) is a separate entity not owned or a subsidiary of (bank), even though they might have common employees. I also understand that none of the products sold through (third party) have any relationship to the bank and are not covered by Federal Deposit Insurance Corporation (FDIC) insurance.

(signature of customer)

(date)

The department agrees such a written acknowledgment would be helpful. The proposed language can be tailored to specific situations, and is an effective way to further clarify to the customer the separateness of the bank and the third party. Banks with limited space may find such a form particularly useful.

2. *Advertising*

Any advertising or promotional material utilized by the bank which mentions the lessee's services, or vice versa, should clearly indicate that the two entities are separate and unrelated concerns, and that the lessee's services are not being offered by the bank.

3. *Access to Bank Premises by Nonbank Employees*

Particular attention should be given to the security of bank operations when determining what type of access to bank premises will be allowed to nonbank employees during hours when the bank is closed. "None" is the best alternative.

Replaces Memo 1995-11 and 1995-12