



# BANKING ISSUANCE

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Comptroller of the Currency  
Administrator of National Banks

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Type: Banking Circular

Subject:

Charges by a Federal Reserve Bank  
Against a National Bank's Reserve  
Account Due to Default on Loan  
Made to a Nonmember Financial  
Institution

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To: Chief Executive Officers of all National Banks, Regional Administrators and Examining Personnel

This issuance concerns Reserve Account Charge Agreements ("Charge Agreements") used by various Federal Reserve Banks ("Reserve Banks"). These agreements are used when a nonmember financial institution borrows funds from a Reserve Bank and the transaction is processed through the reserve account of a national bank with which the nonmember institution has a correspondent relationship; Under the Charge Agreements used by almost all the Reserve Banks, the lending Reserve Bank may charge the national bank's reserve account if default occurs on the nonmember's loan processed through the national bank's account. Under some of the Charge Agreements, the charge is irrevocable, i.e., once the charge is made, the Reserve Bank has used the national bank's reserve account funds to satisfy the nonmember correspondent's defaulted loan. The national bank can seek reimbursement only from that nonmember correspondent or from the collateral pledged by that correspondent to the Reserve Bank. Under the Charge Agreements used by other Reserve Banks, the charge is revocable within a reasonable time. Therefore, if the national bank so requests within a reasonable time, the Reserve Bank will cancel the charge against the national bank's reserve account and proceed directly against the nonmember institution for repayment of that institution's defaulted loan. Under the Charge Agreement utilized by still other Reserve Banks, the charge is revocable upon notice to the Reserve Bank within a stipulated period (often 24 hours but as short as 1 hour). If the national bank fails to give the Reserve Bank notice within the time stipulated, the charge becomes irrevocable. This issuance establishes when national banks may legally enter into the above described Charge Agreements and what safeguards they must establish in order to conform to safe and sound banking practice.

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## LEGALITY OF ENTERING INTO CHARGE AGREEMENTS

As stated in Interpretive Ruling 7.7010 (12 C.F.R. § 7.7010), a national bank may not act as the guarantor of the debts of another absent a substantial interest in the transaction involved or a segregated deposit in an amount sufficient to cover the bank's total potential liability under the guarantee. Maintenance of a correspondent relationship with a financial institution is not such a "substantial interest." In normal circumstances, a national bank will have neither such a substantial interest nor such a segregated deposit when a loan from a Reserve Bank to a nonmember financial institution is processed through the national bank's account at the Reserve Bank. Thus, in normal circumstances, a national bank is not permitted to enter into a Charge Agreement with a Reserve Bank where such a Charge Agreement constitutes a guarantee of the Reserve Bank's loan to the national bank's nonmember correspondent.

It is the position of the Comptroller's Office that an irrevocable Charge Agreement constitutes a binding guarantee of the nonmember correspondent's debt and generally cannot be entered into by a national bank. In contrast, a revocable Charge Agreement is not a binding guarantee of the correspondent's debt since a national bank entering into a revocable Charge Agreement may, at its option, revoke the charge and thus avoid liability for the debt of the nonmember correspondent. Because a revocable Charge Agreement does not constitute a guarantee, it may be legally entered into by a national bank regardless of whether that bank has a substantial interest in the transaction involved or has received a segregated deposit equal to its total liability under the agreement.

## STANDARDS FOR SAFE AND SOUND BANKING PRACTICE

Each bank which enters into a revocable Charge Agreement must establish written procedures which will ensure its ability to consider and effect decisions and actions necessary upon such a charge in a prudent and timely manner. The Comptroller's Office believes that, as a general rule, a Charge Agreement that provides a period of less than 24 hours for revocation of a charge will make the establishment of such procedures extremely difficult, if not impossible. However, the Office will evaluate each bank's compliance with safe and sound banking practice on an individual basis. Thus, procedures developed for revocation periods under 24 hours will not automatically be found inadequate and procedures developed for revocation periods of 24 hours or more will not automatically be found adequate.



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If a bank does not revoke a charge under a revocable Charge Agreement, it has made a loan to its nonmember correspondent. Therefore, a decision to not revoke a revocable charge must be made on prudent credit principles. The resulting loan must comply with safe and sound banking practice and all applicable legal provisions regarding such a loan.

Paul M. Homan  
Senior Deputy Comptroller for Bank Supervision