



FEDERAL RESERVE BANK
OF DALLAS

WILLIAM H. WALLACE
FIRST VICE PRESIDENT
AND CHIEF OPERATING OFFICER

December 11, 1990

DALLAS, TEXAS 75222

Circular 90-87

TO: The Chief Executive Officer of each
member bank and others concerned in
the Eleventh Federal Reserve District

SUBJECT

Amendment to Regulation Y
(Bank Holding Companies and Change in Bank Control)

DETAILS

The Federal Reserve Board has announced approval of an amendment to Regulation Y to permit banks to offer a price reduction on credit cards issued to their customers if the customer also obtains a traditional banking product from any of the credit card bank's affiliates. The amendment will be effective December 18, 1990.

The amendment follows the Board's recent approval of separate requests by Norwest Corporation, Minneapolis, Minnesota, and NCNB Corporation, Charlotte, North Carolina, to consolidate their credit card operations into card-issuing banks and to offer reduced-rate credit cards to customers of their affiliate banks.

ATTACHMENT

A copy of Federal Reserve System Docket No. R-0699 is attached.

MORE INFORMATION

Questions concerning the Board's action should be addressed to Jane Anne Schmoker at (214) 651-6228. For additional copies of this circular, please contact the Public Affairs Department at (214) 651-6289.

Sincerely yours,

FEDERAL RESERVE SYSTEM

12 CFR Part 225

[Regulation Y; Docket No. R-0699]

Exemption Permitting Banks to Offer Reduced-Rate Credit Cards
To Customers of Their Affiliates

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: Section 106 of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. 1971, 1972(1)) ("section 106") generally prohibits banks from offering reduced consideration for credit or other services on the condition that the customer also obtain some additional service from the bank or a holding company affiliate of the bank. This exemption would permit banks to offer a price reduction on credit cards issued to their customers if the customer also obtains a traditional banking product from any of the credit card bank's affiliates.

EFFECTIVE DATE: December 18, 1990.

FOR FURTHER INFORMATION CONTACT: Robert deV. Frierson, Senior Attorney (202/452-3711) or Mark J. Tenhundfeld, Attorney (202/452-3612), Legal Division; or Anthony Cyrnak, Economist (202/452-2917), Division of Research and Statistics, Board of Governors. For the hearing impaired only, Telecommunication Device for the Deaf (TDD), Earnestine Hill or Dorothea Thompson (202/452-3544).

SUPPLEMENTARY INFORMATION:

Background

Section 106 generally prohibits banks from offering reduced consideration for credit or other services if that reduction is conditioned on a requirement that the customer also obtain some additional service from the bank or a holding company affiliate of the bank.^{1/} However, section 106 provides that the Board may, by regulation or order, "permit such exceptions ... as it considers will not be contrary to the purposes" of section 106.

Pursuant to this exemptive authority, the Board recently approved separate requests by Norwest Corporation, Minneapolis, Minnesota ("Norwest"), and NCNB Corporation, Charlotte, North Carolina ("NCNB"), to consolidate their credit card operations into card-issuing banks and to offer reduced-rate credit cards to customers of their affiliate banks.^{2/}

Norwest and NCNB proposed to vary the consideration (including interest rates and fees) charged on a credit card issued by one of their banks if the cardholder also obtained a "traditional banking product" (defined by section 106 as a loan, discount, deposit or trust service) from any of their other

^{1/} Such arrangements constitute tie-ins and may result in a customer being forced or induced to purchase a product that the customer does not want (the "tied product") in order to obtain a product that the customer desires (the "tying product").

^{2/} Norwest Corporation and NCNB Corporation, 76 Federal Reserve Bulletin 702 (1990).

subsidiary banks.^{3/} Regardless of the combination of banking services offered, the proposed variation in consideration would occur on the credit card (the tying product) and was conditioned upon the customer also obtaining traditional banking products (the tied products) from a subsidiary bank of the card-issuing bank's parent holding company. In addition, all products offered under this arrangement were also available to customers for separate purchase.

The Norwest and NCNB proposals were prohibited under the literal terms of section 106. Under its provisions, a bank may not offer reduced-rate credit on the condition that a customer also obtain some additional service from an affiliate of that bank.^{4/} Accordingly, without an exemption under section 106 from the Board, a multi-bank holding company like Norwest and NCNB would be prohibited from offering a reduced-rate credit card at one of its banks on the condition that a customer also obtain

^{3/} For example, a depositor maintaining a minimum deposit balance at any of their affiliate banks might be eligible for a credit card with no membership fee.

^{4/} Section 106 permits a bank to reduce consideration for credit or other services if the customer obtains some other traditional banking service from that bank. This exception does not apply, however, where the credit from one bank is conditioned on obtaining an additional product from an affiliate. Thus, while section 106 permits a bank to require a customer to obtain its own traditional banking services as a condition for reduced-rate credit, it does not permit a bank to impose the same requirements for a traditional banking service offered by an affiliate of the bank.

a traditional banking product from one of its other affiliated banks.

In order to grant an exemption, section 106 requires the Board to find that the reduced-rate credit card arrangement would not be contrary to the purposes of the section. The legislative history indicates that the purpose of the section was to address an underlying Congressional concern regarding fair competition and that its prohibitions were "intended to provide specific statutory assurance that the use of the economic power of a bank will not lead to a lessening of competition or unfair competitive practices."^{5/}

This legislative history also indicates that the Board should exercise its exemptive authority selectively. The Senate banking committee's report states that "the committee expects that by such regulation or order the Board will continue to allow appropriate traditional banking practices."^{6/} The Supplementary Views of Senator Brooke filed with the Senate Report note that "adequate discretion is vested in the Federal

^{5/} S. Rep. No. 1084, 91st Cong., 2d Sess. 16 (1970) ("Senate Report"). The Senate banking committee's report explains: "The purpose of [section 106] is to prohibit anti-competitive practices which require bank customers to accept or provide some other service or product or refrain from dealing with other parties in order to obtain the bank product or service they desire." Senate Report at 17.

^{6/} Senate Report at 17.

Reserve Board to provide exceptions where such are founded on sound economic analysis."^{7/}

In determining whether the proposed exemption would be inconsistent with section 106's purpose and legislative history, the Board has considered it appropriate to analyze the competitiveness of the relevant credit card market. In the Board's view, unless it would be likely that the seller's market power in the credit card market for the tying product is high enough to force a consumer to also purchase on uncompetitive terms a traditional banking service in the tied product market, a reduced-rate credit card arrangement would not appear to produce anticompetitive effects.

The Board has found the relevant market for credit cards to be national in scope^{8/} and, with nearly 5,000 card-issuers, relatively unconcentrated. In the case of Norwest and NCNB, their small market shares and the presence of many other competitors providing credit cards in the tying product market indicated that they could not exercise sufficient market power to impair competition in the tied product market for traditional banking services.^{9/} The Board also noted that both companies

^{7/} Senate Report at 46.

^{8/} First Chicago Corporation, 73 Federal Reserve Bulletin 600 (1987); RepublicBank Corporation, 73 Federal Reserve Bulletin 510 (1987).

^{9/} According to market data as of December 31, 1988, Norwest accounted for less than 1 percent of total credit card
(continued...)

would continue to offer credit cards and traditional banking services separately,^{10/} and, given the competitive nature of the credit card market, these separately available products would be required to be offered at competitive prices.

Under these circumstances, the Board concluded that the Norwest and NCNB proposals were not contrary to the purpose of section 106, and that granting the exemptions was consistent with the legislative history of the Board's authority to permit exemptions for traditional banking services on the basis of economic analysis. Approval was conditioned, however, on the Board's right to terminate the credit card proposals if conditions developed to indicate that the arrangement was resulting in anticompetitive practices that were inconsistent with the purpose of section 106.

In light of section 106's purpose of preventing unfair competitive practices, and the relatively unconcentrated nature of the national credit card market, the Board also considered it appropriate to permit reduced-rate credit card arrangements by

^{9/} (...continued)

balances outstanding and NCNB held only 1 percent among the top 100 card-issuers. Moreover, the top 100 card-issuing institutions accounted for approximately 80 percent of total industry outstandings and Citicorp, the largest single issuer, accounted for 18 percent of all credit card balances outstanding.

^{10/} Under antitrust precedent, anticompetitive concerns are substantially reduced where the buyer is free to take either product by itself even though the seller may also offer the two items as a unit at a single price. Northern Pacific Ry. Co. v. United States, 356 U.S. 1, 6, n.4 (1958).

bank holding companies, without the need for acting on individual requests. Accordingly, the Board proposed an amendment to Regulation Y authorizing bank holding companies generally to offer reduced rates on credit cards for customers of their affiliated depository institutions under the same circumstances discussed in the Norwest and NCNB approvals.^{11/} During the regulatory comment period, the Board received 49 written comments, with 40 in favor of and 9 opposed to the proposal.

Discussion

Commenters opposing the proposed amendment generally argued that reduced-rate credit card arrangements would permit larger bank holding companies to compete unfairly against smaller holding companies for credit card customers. The Board believes, however, that the proposed exemption addresses the potential for unfair competitive practices in several respects. As the Board has previously noted, concerns regarding reduced-rate credit card proposals from an antitrust perspective are substantially reduced when the buyer is free to obtain the tying or tied product separately, thus assuring the availability of these products to customers not wishing to obtain all the products offered in the arrangement. Moreover, the competitiveness of the credit card market would require that the separately available credit cards be offered at competitive prices. In any event, the Board has reserved the right to terminate any reduced-rate credit card

^{11/} 55 FR 26453 (1990).

arrangement offered under the proposed exemption that results in anticompetitive practices.

One commenter disputed the conclusions to be drawn from the data on credit card receivables and alleged that the credit card industry is highly concentrated. As previously discussed in the Norwest and NCNB Order, however, these data confirm the relatively unconcentrated nature of the credit card market. The approximately 5,000 card-issuers in the market for credit card services substantiate the existence of numerous competitors in the present market and the absence of significant barriers for entry by prospective competitors. The largest single issuer has less than 20 percent of all credit card outstandings and cannot be characterized as being dominant enough to exercise significant market power through its market share. In addition, the credit card market is also national in geographic scope. This national scope implies that, regardless of local banking market structure, customers can choose from many competitive alternatives for basic credit card services, thus making it unlikely that any one competitor would be able to exert monopolistic power in any local market for credit cards. And, as noted above, the Board can terminate any reduced-rate credit card program if the facts demonstrate that competitors offering the program can exert sufficient power in this market to result in anticompetitive practices.

Seventeen of the commenters in favor of the proposal have requested that the Board expand the proposal to include one or both of the following: (i) a variation in consideration for any traditional banking product; and (ii) traditional banking products offered by nonbanking subsidiaries in addition to depository subsidiaries of the card-issuing bank's parent holding company.

As discussed above, section 106 permits the Board to approve only exemptions that are not contrary to the purpose of preventing anticompetitive practices. In the case of the reduced-rate credit cards, an analysis of the current credit card market indicates that no seller's market power in this tying product market is high enough to force a consumer to also purchase on uncompetitive terms a traditional banking product in the tied product market.

In the Board's view, analyses of the market for other tying banking products would be appropriate before the Board expanded the scope of the proposed amendment. The Board has found that the competitive characteristics of the credit card market are an appropriate consideration in determining whether an exemption for credit cards would not be contrary to the purposes of section 106 for purposes of exercising its exemptive authority. Accordingly, the Board believes that market analyses for the other proposed tying products would be relevant to the Board's determination of whether those tying products would

result in anticompetitive practices and thus would be inconsistent with the purposes of section 106. In this regard, staff reviews market characteristics of banking products on a continuing basis and analyses for other traditional banking products may be concluded in the future.^{12/}

The Board believes it appropriate, however, to expand the proposed exemption to include traditional banking products offered by both depository and nonbanking subsidiaries of the card-issuing bank's parent holding company. Multi-bank holding companies today offer a variety of traditional banking products through nonbanking subsidiaries. In addition, the Board notes that subsequent Congressional action in other contexts regarding prohibitions similar to section 106 tends to support the inclusion of all subsidiaries within the exemption. For example, Federal thrifts are permitted to offer arrangements with traditional banking services obtained from any of the thrift's affiliates.^{13/} In the Competitive Equality Banking Act of 1987 ("CEBA"), which applied the prohibitions of section 106 to nonbank banks, Congress indicated that these restrictions "would

^{12/} For example, staff has recently completed an analysis of the lending market for small businesses. According to this study, the market for these services is relatively local in scope.

^{13/} 12 U.S.C. § 1464(q)(1). During the enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, amendments to similarly exempt traditional banking services offered by subsidiaries of bank holding companies from section 106's prohibitions were unsuccessfully offered in both House and Senate banking committees.

not be violated by tying one of these traditional banking services offered by a grandfathered nonbank bank to another traditional banking service offered by an affiliate."^{14/} While this excerpt does not accurately reflect the literal terms of section 106, it lends support for expanding the proposed exemption to include traditional banking products offered by any of the card-issuing bank's affiliates, given the lack of economic evidence of anticompetitive effects.^{15/}

Analysis of the final rule

The final rule would permit a bank owned by a bank holding company to vary the consideration (including interest rates and fees) charged on extensions of credit made pursuant to a credit card offered by the bank (including a credit card bank) on the basis of the condition or requirement that a customer also obtain traditional banking products from another subsidiary of the card-issuing bank's parent holding company. However, both the credit card and the traditional banking products offered in the arrangement must be separately available for purchase by the customer. Moreover, the Board may terminate any exemption if

^{14/} H.R. Conf. Rep. No. 261, 100th Cong., 1st Sess. 128-29 (1987).

^{15/} In light of section 106's applicability to nonbank banks, the Board notes that the proposed amendment to Regulation Y for reduced-rate credit cards would also apply to holding companies entitled to grandfathered treatment under CEBA, subject to any additional restrictions imposed on such companies.

facts develop to indicate that the arrangement is resulting in anticompetitive practices.

Regulatory Flexibility Act Analysis

Pursuant to section 605(b) of the Regulatory Flexibility Act (Pub. L. 96-354, 5 U.S.C. 601 et seq.), the Board of Governors of the Federal Reserve System certifies that this final rule will not have a significant economic impact on a substantial number of small entities that will be subject to the regulation.

List of Subjects in 12 CFR Part 225

Administrative practice and procedure, Appraisals, Banks, Banking, Capital adequacy, Federal Reserve System, Holding companies, Reporting and record keeping requirements, Securities, State member banks.

For the reasons set forth in this document, the Board amends 12 CFR Part 225 as follows:

PART 225 - BANK HOLDING COMPANIES AND CHANGE IN BANK CONTROL

1. The authority citation for Part 225 is revised to read as follows:

AUTHORITY: 12 U.S.C. 1817(j)(13), 1818, 1831i, 1843(c)(8), 1844(b), 1972(1), 3106, 3108, 3907, 3909, 3310, and 3331-3351.

2. In § 225.4, the heading to paragraph (d) is revised, paragraph (d) is redesignated as paragraph (d)(1) and new paragraph (d)(2) is added to read as follows:

§ 225.4 Corporate practices.

* * * * *

(d)(1) Limitation on tie-in arrangements.

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(2) Exemption for credit cards. A bank (including a credit card bank) owned by a bank holding company may vary the consideration (including interest rates and fees) charged on extensions of credit made pursuant to a credit card offered by the bank on the basis of the condition or requirement that a customer also obtain a loan, discount, deposit, or trust service (but no other products) from another subsidiary of the card-issuing bank's parent holding company, if the credit card and the loan, discount, deposit, or trust service offered in the arrangement are also separately available for purchase by a customer. The exemption granted pursuant to this paragraph shall terminate upon a finding by the Board that the arrangement is resulting in anticompetitive practices.

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By order of the Board of Governors of the Federal Reserve System, November 8, 1990.

(signed) William W. Wiles

William W. Wiles
Secretary of the Board