FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. **10357**
July 10, 1990]

BANK HOLDING COMPANIES

— Proposed Amendment to Regulation Y Regarding Tie-In Prohibitions

Comments Invited by July 30

— Proposed Revision to an Interpretative Rule Regarding Investment Advisory Activities

Comments Invited by August 9

To All State Member Banks and Bank Holding Companies
in the Second Federal Reserve District, and Others Concerned:

The Board of Governors of the Federal Reserve System has issued the following statements:

Tie-In Prohibitions

The Federal Reserve Board has issued for public comment a proposal to revise section 225.4(d) of the Board's Regulation Y (12 CFR 225.4(d)) to provide a limited exemption from the tie-in prohibitions in Section 106 of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. 1971-78).

Comment is requested by July 30, 1990.

This proposal would permit the credit card-issuing banks of bank holding companies to offer a price reduction on the credit cards they issue in conjunction with traditional banking services provided by their affiliated banks.

Investment Advisory Services

The Federal Reserve Board has issued for public comment a proposal to revise the Board's interpretative rule regarding investment advisory activities of bank holding companies to clarify that a bank holding company and its nonbank subsidiaries may act as an agent for customers in the brokerage of shares of an investment company advised by the holding company or any of its subsidiaries.

Comment is requested by August 9, 1990.

Printed on the following pages is the text of the Board's proposals, which have been reprinted from the *Federal Register*. Comments thereon should be submitted by July 30 on the tie-in proposal, and by August 9 on the interpretative rule, and may be sent to the Board of Governors, as set forth in the notice, or to our Domestic Banking Applications Division.

E. GERALD CORRIGAN,
President.

FEDERAL RESERVE SYSTEM

12 CFR Part 225

[Regulation Y; Docket No. R-0699]

Exemption From Tie-in Prohibitions

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Notice of proposed rulemaking.

SUMMARY: Section 106 of the Bank Holding Company Act Amendments of 1970 ("Section 106") (12 U.S.C. 1971, 1972(1)) prohibits a bank from extending credit, leasing or selling property, furnishing a service, or fixing or varying the consideration for any of the foregoing on the condition that the customer obtain additional credit, property, or service from the bank other than a loan, discount, deposit, or trust service (collectively, "traditional banking services"). Section 106 also prohibits a bank from conditioning either the availability of or consideration for a loan, lease, sale, or service upon the customer obtaining additional credit, property, or service from the bank's parent holding company. This proposed regulation provides an exemption that would allow a bank (including a credit card bank) to vary the consideration for obtaining a credit card from the card-issuing bank on the basis of the condition that the customer also obtain a traditional banking service from a bank or savings institution subsidiary of the card-issuing bank's parent holding company.

DATES: Comments must be submitted on or before July 30, 1990.

ADDRESSES: Comments, which should refer to Docket No. R-0699 may be mailed to the Board of Governors of the Federal Reserve System, 20th and Constitution Avenue NW., Washington, DC 20551, to the attention of Mr. William W. Wiles, Secretary; or delivered to room B-2223, Eccles Building, between 8:45 a.m. and 5:15 p.m. Comments may be inspected in room B-1122 between 9 a.m. and 5 p.m., except as provide in § 261.8 of the Board's Rules Regarding Availability of Information, 12 CFR 261.8.

FOR FURTHER INFORMATION CONTACT: Robert deV. Frierson, Senior Attorney (202/452-3711) or Mark J. Tenhundfeld, Attorney (202/452-3612), Legal Division, Board of Governors; 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 a bank from tying reduced consideration for credit or other service to the requirement that a customer also obtain some additinal service from the bank or a holding company affiliate of the bank. Tying occurs when the customer is 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). There is an exception to this tying prohibition that permits a bank to reduce the consideration for credit or other service 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 tied to an additional service from an affiliate. Thus, while section 106 permits a bank to tie its own traditional banking services, it does not permit the bank to tie one of its services to a traditional banking service offered by an affiliate. Section 225.4(d) of the Board's Regulation Y (12 CFR 225.4(d)) implements these anti-tying provisions.

Section 106 provides that the Board may, by regulation or order, "permit such exceptions * * * as it considers will not be contrary to the purpose of this section." The Senate banking committee's report explains that section 106 was added to the House proposal in order to prevent the anticompetitive effects of tying arrangements:

> The purpose of this provision 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.[1]

The underlying Congressional concern addressed by section 106 was fair competition and its provisions 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." [2] The Conference Report explains that tie-ins may produce anticompetitive results because customers, forced to accept other products or services along with the product which the customer seeks, "no longer purchase a product or service on its own economic merit." [3] In this regard, section 106's prohibitions exceeded applicable antitrust standards and imposed a *per se* prohibition against tie-ins involving credit.[4]

The legislative history also indicates that the Board should exercise its exemptive authority selectively. The Senate Report states that

> The committee expects that by such regulation or order the Board will continue to allow appropriate traditional banking practices.[5] The Supplementary Views of Senator Brooke filed with the Senate Report noted that adequate discretion is vested in the Federal Reserve Board to provide exceptions where such are founded on sound economic analysis.[6]

The Board recently approved the requests by Norwest Corporation and NCNB Corporation for an exemption to permit their banks to offer a credit card at lower costs in conjunction with traditional banking services provided by their other affiliate banks.[7] In its Order, the Board permitted banks owned by Norwest and NCNB to vary the consideration (including interest rates and fees) charged in connection with extensions of credit 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 a loan, discount, deposit, or trust service from another bank that is a subsidiary of the card-issuing bank's parent holding company, provided that the products so offered are separately available for purchase by a customer. The Board's approval was also subject to the Board's authority to terminate these exemptions in the event that facts develop in the future that indicate that the tying arrangement is

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[1] S. Rep. No. 1084, 91st Cong., 2d Sess. 17 (1970) ("Senate Report"). Senator Sparkman, Chairman of the Senate banking committee, explained that although section 106 had been modified on the Senate floor to include an exemption for traditional banking products (*see* 116 Cong. Rec. 32,124-33 for debate on this amendment), this explanation should continue to be the basis for interpreting the tie-in prohibitions. 116 Cong. Rec. 42,426.

[2] Senate Report at 16.

[3] Rep. No. 91-1747, 91st Cong., 2d Sess. 18 (1970).

[4] In commenting on the effects of section 106, the Justice Department noted that "the proposed new section would go beyond [*Fortner Enterprises, Inc. v. United States Steel Corp.*, 394 U.S. 495 (1968)], which did not go so far as to hold tie-ins involving credit illegal per se." Senate Report at 48. Accordingly, it has been held that impermissible tying arrangements under section 106 are unlawful even without a showing of adverse effects on competition or the degree of bank control over the tying product. *Gage v. First Federal Savings and Loan Ass'n of Hutchinson, Kansas*, 717 F. Supp. 745 (D.Kan. 1989); *Parsons Steel, Inc. v. First Alabama Bank of Montgomery*, 679 F.2d 242 (11th Cir. 1982).

[5] Senate Report at 17.

[6] Senate Report at 46.

[7] *Norwest Corporation and NCNB Corporation*, 76 Federal Reserve Bulletin _____ (Order dated June 20, 1990).

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resulting in anticompetitive practices and thus would be inconsistent with the purpose of section 106.

Proposal

The proposed regulation would make this exemption available to bank holding companies generally, without the need for Federal Reserve System action on individual requests. The Board believes that this amendment to Regulation Y is not contrary to the purpose of section 106, and that the exemption is consistent with the legislative authorization to permit exemptions for traditional banking services on the basis of economic analysis.

In this regard, the Board notes that subsequent Congressional actions in other contexts regarding anti-tying provisions tend to support the proposal. For example, Federal thrifts are permitted to tie traditional banking services obtained from the thrift's affiliates.[8] In the Competitive Equality Banking Act of 1987, which applied the tie-in restrictions to nonbank banks, Congress indicated that "the antitying restrictions [of section 106] would 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."[9] While this excerpt does not accurately reflect the terms of section 106, it lends support for the proposed rule, in the absence of any economic evidence indicating anticompetitive effects.

In analyzing potential anticompetitive effects of the proposal, it is appropriate to consider the competitiveness of the relevant credit card market. In the Board's view, unless it is 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, the proposed tie-in between credit cards and traditional banking services would not appear to produce anticompetitive effects.

The relevant market for credit cards is national in scope and, with nearly 5,000 card-issuers, relatively unconcentrated.[10] In addition, under the proposed amendment, credit cards and traditional banking services will be required to be offered separately,[11] and given the competitive nature of the credit card market, the Board believes that banks will be required to offer these separately available credit cards at competitive prices.

Analysis of Proposed Amendment

The proposed amendment to Regulation Y would permit a bank owned by a bank holding company to vary the consideration (including interest rates and fees) charged in connection with extensions of credit 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 a traditional banking service from a bank or savings institution subsidiary of the card-issuing bank's parent holding company. However, both the credit card and the traditional banking service in the tying arrangement will be required to be separately available for purchase by the customer. Moreover, the Board may modify or terminate a bank holding company's exemption in the event that the Board determines that the tying arrangement has resulted 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 notice of proposed rulemaking, if adopted as a final rule, will not have a significant economic impact on a substantial number of small entities that would 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 recordkeeping requirements, Securities, State member banks.

PART 225—BANK HOLDING COMPANIES AND CHANGE IN BANK CONTROL

For the reasons set forth in this notice, the Board proposes to amend 12 CFR part 225 as follows:

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

Authority: 12 U.S.C. 1817(j)(13), 1818, 1831, 1831i, 1843(c)(8), 1844(b), 1971(1), 3106, 3108, 3907, 3909 and sections 1101–1122 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 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 owned by a bank holding company may vary the consideration (including interest rates and fees) charged in connection with extensions of credit 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 a loan, discount, deposit, or trust service from a bank or savings institution subsidiary of the card-issuing bank's parent holding company, provided that the products offered are separately available for purchase by a customer. A bank holding company's authority under this exemption is subject to modification or termination by the Board in the event that the Board determines that anticompetitive practices have resulted from the tying arrangement.

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Board of Governors of the Federal Reserve System, June 22, 1990.

William W. Wiles,

Secretary of the Board.

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[8] 12 U.S.C. 1464(q)(1). During the consideration of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, unsuccessful amendments to similarly exempt traditional banking services offered by subsidiaries of bank holding companies from section 106's tying prohibition were offered in both House and Senate banking committees.

[9] Conference Report, Rep. No. 261, 100th Cong., 1st Sess. 128–29 (1987).

[10] *First Chicago Corporation*, 73 Federal Reserve Bulletin 600 (1987); *RepublicBank Corporation*, 73 Federal Reserve Bulletin 510 (1987). Market data are as of December 31, 1988. The top 100 card-issuing institutions account for approximately 80 percent of total industry outstandings and Citicorp, the largest single issuer, accounts for 18 percent of all credit card balances outstanding.

[11] Under antitrust precedent, concerns over tying arrangements 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 R. Co.* v. *United States*, 356 U.S. 1, 6, n.4. (1958).

FEDERAL RESERVE SYSTEM

12 CFR Part 225

[Regulation Y; Docket No. R–0698]

Bank Holding Companies and Change in Bank Control; Investment Adviser Activities

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Notice of proposed revision to an interpretive rule.

SUMMARY: The Board seeks public comment on a proposal to revise the Board's interpretive rule regarding investment advisory activities of bank holding companies to clarify that a bank holding company and its nonbank subsidiaries may act as an agent for customers in the brokerage of shares of an investment company advised by the holding company or any of its subsidiaries.

DATES: Comments must be received on or before August 9, 1990.

ADDRESSES: All comments, which should include a reference to Docket No. R–0698, should be mailed to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, Washington, DC 20551, or delivered to room B–2222, 20th and Constitution Avenue, NW., Washington, DC, between 8:45 a.m. and 5:15 p.m. weekdays. Comments may be inspected in room B–1122 between 8:45 a.m. and 5:15 p.m. weekdays.

FOR FURTHER INFORMATION CONTACT: Scott G. Alvarez, Assistant General Counsel (202/452–3583), or Brendan T. Gormley, Staff Attorney (202/452–3721), Legal Division; Robert S. Plotkin, Assistant Director (202/452–2782), Division of Banking Supervision and Regulation. For the hearing impaired only, Telecommunication Device for the Deaf (TDD), Earnestine Hill or Dorothea Thompson (202/452–3544).

SUPPLEMENTARY INFORMATION:

(1) *Proposed revision to an Interpretive Rule.* The Board's interpretive rule regarding investment advisory activities [12 CFR 225.125(h)] states that a bank holding company may not engage in the "sale or distribution" of shares of investment companies advised by the bank holding company or one of its nonbank subsidiaries. The Board proposes to modify this interpretive rule to clarify that a bank holding company and its nonbank subsidiaries may broker shares, solely as agent for the account of customers, of both open and closed-end investment companies that are advised by the bank holding company or any of its bank or nonbank subsidiaries.

The Board has previously determined, and the Supreme Court has agreed, that a nonbank subsidiary engaged in brokerage activities is not engaged in the "issue, flotation, underwriting, public sale, or distribution of securities" for purposes of the Glass-Steagall Act. *BankAmerica Corporation*, 69 Federal Reserve Bulletin 105, 114 (1983), *aff'd, Securities Industry Association* v. *Board of Governors*, 468 U.S. 207 (1984). Accordingly, the Board proposes that language be added to its interpretive rule to clarify that the reference in paragraph (h) of that rule to "sale or distribution" of shares of investment companies advised by the bank holding company or its subsidiaries does not prohibit a bank holding company or its nonbank subsidiaries from acting solely as agent for the account of customers in the purchase or sale of shares of such investment companies. The Board has already determined that bank holding companies may act as agent for the account of customers in the purchase and sale of shares of investment companies advised by bank subsidiaries of the bank holding company. *Northwest Corporation*, 76 Federal Reserve Bulletin 79 (1990) ("*Norwest*"). In that order, the Board indicated that it would seek public comment on a proposal to amend § 225.125(h).

The proposal also would permit bank holding companies and their nonbank subsidiaries to provide investment advice to customers regarding the purchase and sale of shares of investment companies advised by a holding company affiliate. Under the proposal, a holding company that conducts this combination of activities would be required to disclose its dual roles to customers. The proposal would also require officers and employees of the holding company to caution customers to read the prospectus of an investment company before investing in it and advise customers in writing that the investment company's shares are not obligations of any bank, are not insured by the Federal Deposit Insurance Corporation, and are not endorsed or guaranteed in any way by any bank. The Office of the Comptroller of the Currency permits national banks to conduct these activities simultaneously.[1] The proposal would also amend or remove certain other limitations in paragraph (h) in a manner consistent with this proposal.

The Board also seeks public comment on whether it is appropriate to amend any of the restrictions in paragraph (g) of this interpretive rule regarding the purchase of shares of investment companies advised by the bank holding company, extensions of credit by the bank holding company to such an investment company, and certain other transactions. [12 CFR 225.125(g)].

(2) *Submission of Comments.* To aid the Board in its consideration of the proposed rulemaking, interested persons may express their views on any matter raised by this proposal. Any request for a hearing on this matter should be accompanied by a statement summarizing the evidence the person requesting the hearing proposes to submit or to elicit at the hearing and a statement of the reasons why this matter may not be resolved without a hearing.

Regulatory Flexibility Act Analysis

The Board certifies that the proposed regulation will not have a significant economic impact on a substantial number of small entities within the meaning of the Regulatory Flexibility Act (5 U.S.C. 601). This proposal would not place additional burdens on any bank holding company. It would clarify the rules as they currently apply to all bank holding companies.

List of Subjects in 12 CFR Part 225

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

For the reasons set forth in this notice, and pursuant to the Board's authority under section 5(b) of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1844(b)), the Board proposes to amend 12 CFR part 225 as follows:

PART 225—BANK HOLDING COMPANIES AND CHANGE IN BANK CONTROL

1. The authority citation for part 225 continues to read as follows:

Authority: 12 U.S.C. 1817(j)(13), 1818, 1831i, 1843(c)(8), 1844(b), 3106, 3108, 3907 and 3909.

2. In § 225.125, paragraph (h) is revised to read as follows:

[1] *See* letter dated December 7, 1987, from J. Michael Shephard, Senior Deputy Comptroller for Corporate and Economic Programs regarding First Union National Bank of North Carolina.

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§ 225.125 Investment activities.

* * * * *

(h) Under section 20 of the Glass-Steagall Act, a member bank is prohibited from being affiliated with a company that directly, or through a subsidiary, engages principally in the issue, flotation, underwriting, public sale, or distribution of securities. The Board has determined that the conduct of securities brokerage activities by a bank holding company or its nonbank subsidiaries is not covered by this provision of the Glass-Steagall Act, and the U.S. Supreme Court has upheld that determination. *See Securities Industry Ass'n* v. *Board of Governors*, 468 U.S. 207 (1984); *see also Securities Industry Ass'n* v. *Board of Governors*, 821 F.2d 810 (D.C. Cir. 1987) *cert. denied*, 484 U.S. 1005 (1988). Accordingly, the Board believes that a bank holding company and any of its nonbank subsidiaries may, with appropriate authorization under the Bank Holding Company Act and Regulation Y, purchase and sell shares, upon the order and for the account of customers of the holding company or the nonbank subsidiary, of an investment company for which the bank holding company or any of its subsidiaries acts as an investment adviser. In addition, the bank holding company and any of its nonbank subsidiaries may provide investment advice to customers with respect to the purchase or sale of shares of an investment company for which the holding company or any of its subsidiaries acts as an investment adviser if the holding company or nonbank subsidiary discloses to the customer the company's role as adviser to the investment company. The bank holding company should also instruct its officers and employees to caution customers to read the prospectus of an investment company before investing and must advise customers in writing that the investment company's shares are not obligations of, or endorsed or guaranteed in any way by, any bank, and are not insured by the Federal Deposit Insurance Corporation.

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Board of Governors of the Federal Reserve System, June 18, 1990.

William W. Wiles,

Secretary of the Board.

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