

**FEDERAL RESERVE BANK
OF NEW YORK**

[Circular No. **10784**]
May 17, 1995]

BANK HOLDING COMPANIES

Revisions to the Anti-Tying Provisions of Regulation Y

Effective May 26, 1995

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

Following is the text of a statement issued by the Board of Governors of the Federal Reserve System announcing the adoption of a regulatory “safe harbor” from the anti-tying restrictions of its Regulation Y:

The Federal Reserve Board has announced adoption of a regulatory “safe harbor” from the anti-tying restrictions of section 106 of the Bank Holding Company Act Amendments of 1970 and the Board’s Regulation Y (Bank Holding Companies and Change in Bank Control).

The regulation is effective May 26, 1995.

The safe harbor permits any bank or nonbank subsidiary of a bank holding company to offer a “combined-balance discount” — that is, a discount based on a customer maintaining a combined minimum balance in products specified by the company offering the discount.

Enclosed — for depository institutions, bank holding companies, and others who maintain sets of the Board’s regulations — is the text of the amendments to Regulation Y as published in the *Federal Register*. Others may obtain copies by calling the Circulars Division (Tel. No. 212-720-5215 or 5216). Questions on this matter may be directed to our Banking Applications Department (Tel. No. 212-720-5861).

WILLIAM J. McDONOUGH,
President.

BANK HOLDING COMPANIES AND CHANGE IN BANK CONTROL
AMENDMENTS TO REGULATION Y

Revisions to Tying Restrictions

Effective May 26, 1995

FEDERAL RESERVE SYSTEM

12 CFR Part 225

[Regulation Y; Docket No. R-0851]

**Revisions Regarding Tying
Restrictions**

AGENCY: Board of Governors of the
Federal Reserve System.

ACTION: Final rule.

SUMMARY: The Board is adopting a regulatory "safe harbor" from the anti-tying restrictions of section 106 of the Bank Holding Company Act Amendments of 1970 and the Board's Regulation Y. The safe harbor permits any bank or nonbank subsidiary of a bank holding company to offer a "combined-balance discount"—that is, a discount based on a customer maintaining a combined minimum

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balance in products specified by the company offering the discount.

EFFECTIVE DATE: May 26, 1995.

FOR FURTHER INFORMATION CONTACT:

Gregory A. Baer, Managing Senior Counsel (202/452-3236), or David S. Simon, Attorney (202/452-3611), Legal Division; or Anthony Cymak, Economist, (202/452-2917), Division of Research and Statistics, Board of Governors of the Federal Reserve System. For the hearing impaired only, Telecommunication Device for the Deaf (TDD), Dorothea Thompson (202/452-3544).

SUPPLEMENTARY INFORMATION:

Background

Section 106(b) of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. 1972) generally prohibits a bank from tying a product or service to another product or service offered by the bank or by any of its affiliates.¹ A bank engages in a tie for purposes of section 106 by conditioning the availability of, or offering a discount on, one product or service (the "tying product") on the condition that the customer obtain some additional product or service (the "tied product") from the bank or from any of its affiliates. Violations of section 106 can be addressed by the Board through an enforcement action, by the Department of Justice through a request for an injunction, or by a customer or other party through an action for damages. 12 U.S.C. 1972, 1973, and 1975.

Section 106 contains an explicit exception (the "statutory traditional bank product exception") that permits a bank to tie a product or service to a loan, discount, deposit, or trust service offered by that bank. The Board has extended this exception by providing that a bank or any of its affiliates also may vary the consideration for a traditional bank product on condition that the customer obtain another traditional bank product from an affiliate (the "regulatory traditional bank product exception").²

Section 106 authorizes the Board to grant exceptions to its restrictions by regulation or order. On October 19, 1994, the Board issued an order permitting the subsidiary banks of Fleet Financial Group, Inc., Providence, Rhode Island (Fleet) to offer a discount on the monthly service fee charged for its "Fleet One Account" to customers

who maintain a combined minimum balance of at least \$10,000 in one or more products selected from a menu of eligible Fleet products. All products offered as part of this arrangement were separately available to customers at competitive prices. In granting Fleet's request, the Board determined that, to the extent that Fleet's combined-balance discount was prohibited by section 106, an exemption was warranted given the public benefits and absence of anti-competitive concerns generated by the arrangement.

Final Rule

On October 21, 1994, the Board proposed a regulatory safe harbor from section 106 for combined-balance discounts similar to that offered by Fleet (59 FR 53761, October 26, 1994). The proposal would have permitted any bank to offer a combined-balance discount provided that (1) the bank offered deposits, (2) all such deposits were considered in the arrangement, and (3) all balances in products eligible to be contributed to the minimum balance counted equally towards the minimum balance. In addition, all products involved in the arrangement were required to be separately available for purchase. The Board proposed the safe harbor to provide certainty as to the general permissibility of combined-balance discounts similar to that proposed by Fleet, and because it believed that such discounts are pro-consumer and not anti-competitive.

As noted above, the proposal included a requirement that all deposits count toward the minimum balance. The Board was concerned that absent such a requirement, combined-balance discount plans could be constructed so that a non-traditional bank product, such as securities brokerage services, represented the only viable option for a customer to reach the minimum balance. Under the Board's proposal, a customer could have qualified for the discount based solely on deposit balances. Therefore, there would be no incentive for a customer to establish a securities brokerage account, or any other non-traditional bank product, that the customer did not want in order to obtain the discount.³

³ The Board also noted that, under the statutory and regulatory traditional bank product exceptions, a bank already could offer a combined-balance discount where all products in an arrangement were traditional bank products. The proposed safe harbor would simply permit a bank to increase customer choice by adding a customer's securities brokerage account or other non-traditional products to the menu of traditional bank products that count toward the minimum balance.

Summary of Comments

The Board received 58 comments on its proposal. Those commenting included 42 banking organizations, seven trade associations representing the banking industry, six Reserve Banks, two thrifts, and one law firm representing numerous insurance trade associations. Commenters overwhelmingly supported the Board's proposal because they believed that it would provide benefits to both consumers and banks.⁴ Commenters stated that the proposal would provide customers increased opportunities to obtain services from a bank at discounted prices based on the customer's overall relationship with the bank by allowing customers to meet combined-balance requirements through non-traditional products as well as traditional bank products.

Commenters also supported the proposed safe harbor because it would permit banks to market products more efficiently and compete more effectively with their nonbanking competitors who currently offer combined-balance discount arrangements. In addition, commenters commended the Board for recognizing that the financial services industry is evolving as banks provide customers a broader range of financial services. The proposed safe harbor would permit banks to package these products and therefore attract and retain more customers.

A few commenters suggested modifications to the Board's proposal and recommended that the safe harbor be enlarged. First, six commenters objected to the requirement that the bank offering the discount also offer deposits because this would prevent a nonbank subsidiary of a bank holding company—for example, a trust company—from offering the type of combined-balance discount proposed by the Board.⁵ Commenters believed that customers could be protected from any anti-competitive effects so long as an affiliated bank offered deposits and those deposits count towards the minimum balance.

⁴ One commenter continued to oppose blanket exceptions to section 106, recommending that the Board act on exemption requests on a case-by-case basis. As noted below, the Board believes that a safe harbor can be designed narrowly enough to prevent anti-competitive effects.

⁵ Under the Board's Rules, a nonbank subsidiary of a bank holding company could offer a combined-balance discount involving products offered by the company and its nonbank affiliates so long as no bank was involved in the arrangement. See 12 CFR 225.7(b)(3). Because combined-balance discount arrangements under this proposal include products and services offered by banks and nonbanks, a further exception is required.

¹ Although section 106 applies only when a bank offers the tying product, the Board in 1971 extended the same restrictions to bank holding companies and their nonbank subsidiaries. See 12 CFR 225.7(a).

² See 12 CFR 225.7(b)(2).

Second, thirteen commenters sought modification to the requirement that all deposits be eligible products (that is, count toward the combined minimum balance). Commenters argued that deposits should not be distinguished from other traditional bank products and that therefore the safe harbor should include plans where, for example, loans are among the eligible products but deposits are not. Commenters also argued that requiring all deposits at a bank to be counted as eligible products was unnecessary and burdensome, and that a requirement that a "substantial majority" or "all types" of deposits would serve to prevent anti-competitive arrangements.

Finally, eight commenters objected to the requirement that all eligible products count equally toward the minimum balance, arguing that different products impose different costs on banks and that a company should be able to weight the products in an economically rational way.⁶

Consideration of Comments

The Board agrees with the commenters that customers should be able to count deposits at an affiliated bank toward a minimum balance, and thus that a trust company, for example, should be able to offer a combined-balance discount arrangement that includes deposits at its affiliated bank. Accordingly, the final rule has been modified so that a combined-balance discount arrangement involving products from banks and nonbanks also may be offered by a nonbank subsidiary of a bank holding company so long as a customer may use deposit balances at an affiliated bank to reach the minimum balance required to obtain the discount. This modification assumes that the affiliated bank offering the eligible deposits is reasonably accessible to the customer.

As noted above, the Board proposed the requirement that a bank include deposits among the eligible products in order to ensure that any exempt combined-balance discount would offer customers meaningful choices and therefore could not have an anti-competitive effect. Loans, discounts, or

⁶ One commenter representing the insurance industry indicated that the inclusion of certain insurance products in a combined-balance discount arrangement may undermine or perhaps contradict state insurance laws which generally prohibit insurance agents from varying the consideration charged for insurance products. The Board's regulation is not intended to, and does not, exempt any arrangements from state or federal law. Companies offering combined-balance discount arrangements are responsible for ensuring that these arrangements comply with all applicable state and federal restrictions.

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trust services—the other "traditional bank products" that commenters suggested should be able to replace deposits in a combined-balance arrangement—may not be so viable a choice for many customers. While the Board believes that deposits should in almost every case be an attractive option, a large trust account or mortgage loan may be a realistic option for only a small percentage of customers. Without deposits as eligible products, customers who are not eligible for a large trust account or mortgage loan may effectively be required to elect another, non-traditional, product in order to obtain the combined-balance discount. Thus, the Board is maintaining a deposit requirement for combined-discount plans that fall under this safe harbor.⁷ For similar reasons, the Board is not adopting the suggestion by commenters that only some deposits be required to count toward the minimum balance, simply because it is impossible to predict the effect of this more malleable standard.

The Board recognizes, however, that discount arrangements other than those within the safe harbor may also be consistent with the purposes of section 106. The Board will continue to consider such plans on a case-by-case basis and is delegating authority to approve such plans to the General Counsel. The Board will also, in appropriate cases, expand the safe harbor by rule.

The Board shares commenters' concerns that the proposal would prevent banks from assigning products different weights in counting them toward the minimum balance, and thereby could force banks to price their products irrationally. Commenters stressed that some products are more profitable than others, and that different weights should be assigned accordingly. Although there is a concern that weighting could be used to require purchase of certain non-traditional products, the Board believes this concern can be addressed by the narrower requirement that any deposit included in a combined-balance discount arrangement count at least as much toward the minimum balance as any non-deposit. This approach, which was suggested by several commenters, will allow companies to assign different weights among deposits and non-deposits.⁸

⁷ The Board also is retaining the requirement that all products involved in a combined-balance discount arrangement are separately available for purchase.

⁸ For example, a bank could count toward the minimum balance 100 percent of demand deposits, 80 percent of certificates of deposit, 70 percent of

One commenter argued that combined-balance discounts do not violate section 106 when a multiplicity of options that includes traditional bank products means that there is no "condition or requirement" that the customer purchase a non-traditional bank product. However, the commenter acknowledged that a bank could effectively tie through differential pricing. In order to address this possibility, the commenter favored general language providing that combined-balance discounts generally are not covered by section 106 so long as all eligible products are "meaningful alternatives." The commenter urged the Board to adopt this reading as an interpretation, in lieu of a safe harbor.

As discussed in the preamble to the proposed rule, section 106 covers any condition or requirement that a customer purchase "some additional product," which would appear to include combined-balance discounts. The statutory and regulatory traditional bank product exceptions would clearly exempt combined-balance discounts where all eligible products are traditional bank products. However, the question is whether, when both traditional and non-traditional bank products are included in the list of eligible products: (1) The transaction continues to be covered, does not qualify for the traditional bank product exceptions, and therefore requires an exemption, or (2) the transaction is not covered by section 106 because it is possible for a customer to meet the minimum balance through traditional products. The commenter urges the Board to adopt the second interpretation with the added requirement that the choice of traditional products be "meaningful."

The Board sees no need to resolve this issue in prescribing the final rule, as any interpretation would not be binding and the need for the safe harbor would be the same in either case. Even under the second interpretation, there would remain confusion about what constitutes sufficiently "meaningful" choice among traditional bank products so that a combined-balance discount is not covered by section 106.

Related Issue

As in past rulemakings in the tying area, the Board has received numerous comments recommending that the Board repeal its extension of section 106 to bank holding companies and their

mutual fund shares, and 60 percent of stock held in a brokerage account. So long as the percentages assigned to all deposits are higher than the percentages assigned to the non-deposits, the safe harbor would apply.

nonbank subsidiaries. These comments argue that section 106, by its terms, only applies to banks and the Board's extension of these restrictions places bank holding companies and their nonbank subsidiaries at a competitive disadvantage. These commenters emphasize that, even without these restrictions, bank holding companies and their nonbank subsidiaries remain subject to the antitrust laws. The Board has this matter under consideration and has asked staff to analyze whether additional steps should be taken.

(ii) Balances in deposits count at least as much as non-deposit products toward the minimum balance.

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By order of the Board of Governors of the Federal Reserve System, April 19, 1995.

William W. Wiles,

Secretary of the Board.

[FR Doc. 95-10120 Filed 4-24-95; 8:45am]

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Paperwork Reduction Act

No collections of information pursuant to section 3504(h) of the Paperwork Reduction Act (44 U.S.C. 3501 et seq.) are contained in the final rule.

Regulatory Flexibility Act

It is hereby certified that this final rule will not have a significant economic impact on a substantial number of small entities.

List of Subjects in 12 CFR Part 225

Administrative practice and procedure, Banks, banking, Federal Reserve System, Holding companies, Reporting and recordkeeping requirements, Securities.

For the reasons set forth in the preamble, the Board amends 12 CFR Part 225 as set forth below:

PART 225—BANK HOLDING COMPANIES AND CHANGE IN BANK CONTROL (REGULATION Y)

1. The authority citation for 12 CFR part 225 continues to read as follows:

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

2. In section 225.7, a new paragraph (b)(4) is added to read as follows:

§ 225.7 Tying restrictions.

* * * * *

(b) * * *

(4) *Safe harbor for combined-balance discounts.* A bank holding company or any bank or nonbank subsidiary thereof may vary the consideration for any product or package of products based on a customer's maintaining a combined minimum balance in certain products specified by the company varying the consideration (eligible products), if:

(i) That company (if it is a bank) or a bank affiliate of that company (if it is not a bank) offers deposits, and all such deposits are eligible products; and