

## **FEDERAL RESERVE SYSTEM**

### **12 CFR Part 225**

**[Regulation Y; Docket No. R-1159]**

#### **Bank Holding Companies and Change in Bank Control: Exception to Anti-Tying Restrictions**

**AGENCY:** Board of Governors of the Federal Reserve System.

**ACTION:** Proposed rule with request for public comment.

**SUMMARY:** The Board proposes to adopt an exception to the anti-tying restrictions of section 106 of the Bank Holding Company Act Amendments of 1970 in order to equalize the treatment of financial subsidiaries of banks under section 106. The proposed exception provides that a financial subsidiary of a state nonmember bank shall be treated as an affiliate of the bank, and not as a subsidiary of the bank, for purposes of section 106. The anti-tying restrictions of section 106 generally apply to subsidiaries, but not affiliates, of banks. Financial subsidiaries of national and state member banks already are treated as affiliates (and not subsidiaries) of the parent bank for purposes of section 106.

**DATES:** Comments must be received on or before September 30, 2003.

**ADDRESSES:** Comments should refer to Docket No. R-1159 and may be mailed to Ms. Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20<sup>th</sup> Street and Constitution Avenue, N.W., Washington, D.C. 20551. However, because paper mail in the Washington area and at the Board of Governors is subject to delay, please consider submitting your comments by e-mail to [regs.comments@federalreserve.gov](mailto:regs.comments@federalreserve.gov) or faxing them to the Office of the Secretary at 202-452-3819 or 202-452-3102. Members of the public may inspect comments in Room MP-500 of the Martin Building between 9:00 a.m. and 5:00 p.m. on weekdays pursuant to § 261.12, except as provided in § 261.14, of the Board's Rules Regarding Availability of Information (12 CFR 261.12 and 261.14).

**FOR FURTHER INFORMATION CONTACT:** Kieran J. Fallon, Senior Counsel (202-452-5270), Mark E. Van Der Weide, Counsel (202-452-2263), or Andrew S. Baer, Counsel (202-452-2246), Legal Division, Board of Governors of the Federal Reserve System, 20<sup>th</sup> Street and Constitution Avenue, N.W., Washington, D.C. 20551. For users of Telecommunications Device for the Deaf (TDD) only, contact 202-263-4869.

#### **SUPPLEMENTARY INFORMATION:**

##### **Background**

Section 106 of the Bank Holding Company Act Amendments of 1970 (section 106) generally prohibits a bank from conditioning the availability or price of one product or service

(the “desired product”) on a requirement that the customer obtain another product or service (the “tied product”) from the bank or an affiliate of the bank.<sup>1</sup> For example, the statute prohibits a bank from requiring that a prospective borrower purchase homeowners insurance from the bank or an affiliate of the bank in order to obtain a mortgage loan from the bank. Section 106 also contains several exceptions to its general prohibitions and authorizes the Board to grant any additional exception from the statute’s prohibitions, by regulation or order, that the Board determines “will not be contrary to the purposes” of the statute.<sup>2</sup>

Section 106 applies only to tying arrangements imposed by a bank, and generally does not apply to tying arrangements imposed by a nonbank affiliate of a bank. Because a subsidiary of a bank is considered to be part of the bank for most supervisory and regulatory purposes under the Federal banking laws, the restrictions in section 106 generally apply to tying arrangements imposed by a subsidiary of a bank in the same manner that the statute applies to the parent bank itself. Thus, a subsidiary of a bank generally is prohibited from conditioning the availability or price of a product on the customer’s purchase of another product from the subsidiary, its parent bank, or any affiliate of its parent bank.

The Board is publishing elsewhere in today’s Federal Register a proposed interpretation of section 106 and related supervisory guidance with a request for public comment. The interpretation includes an extensive discussion of the scope and restrictions of section 106, as well as the statutory and regulatory exceptions to the statute’s prohibitions.

## **Proposed Rule**

Federal law authorizes national and state member banks that meet certain conditions to own or control a financial subsidiary.<sup>3</sup> A financial subsidiary of a national or state member bank may engage in certain activities -- such as underwriting and dealing in corporate debt and equity securities -- that the parent bank is not permitted to conduct directly. Unlike other subsidiaries, a financial subsidiary of a national or state member bank is treated as an affiliate of the bank, and not as a subsidiary of the bank, for purposes of section 106.<sup>4</sup> Accordingly, a financial subsidiary of a national or state member bank is not subject to the anti-tying restrictions of section 106. However, tying arrangements imposed by a financial subsidiary of a national or state member

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<sup>1</sup> 12 U.S.C. 1972(1)(A) and (B). Section 106 also prohibits a bank from conditioning the availability or price of one product on a requirement that the customer (i) provide another product to the bank or an affiliate of the bank; or (ii) not obtain another product from a competitor of the bank or from a competitor of an affiliate of the bank. 12 U.S.C. 1972(1)(C), (D), and (E).

<sup>2</sup> 12 U.S.C. 1972(1).

<sup>3</sup> See 12 U.S.C. 24a, 335. In order to be eligible to own or control a financial subsidiary, the national or state member bank and its depository institution affiliates must satisfy certain capital, managerial, Community Reinvestment Act (12 U.S.C. 2901 et seq.), and other requirements.

<sup>4</sup> See 12 U.S.C. 1971; 12 CFR 208.73(e).

bank, like tying arrangements imposed by any other affiliate of a bank, remain subject to the tying restrictions contained in the Federal antitrust laws.<sup>5</sup>

Federal law also authorizes state nonmember banks that meet certain eligibility requirements to own or control a financial subsidiary.<sup>6</sup> The Board proposes to adopt an exception under section 106 that would allow a financial subsidiary of a state nonmember bank to be treated as an affiliate of the parent bank, and not as a subsidiary of the bank, for purposes of section 106. The Board believes that providing equal treatment of all financial subsidiaries of banks under section 106 is appropriate to ensure competitive equality and would not be contrary to the purposes of section 106.<sup>7</sup> The Board invites comment on all aspects of the proposed exception.

### **Plain Language**

Section 722 of the Gramm-Leach-Bliley Act requires the Board to use “plain language” in all proposed and final rules published after January 1, 2000.<sup>8</sup> In light of this requirement, the Board has sought to present the proposed rule in a simple and straightforward manner. The Board invites comment on whether the Board could take additional steps to make the proposed rule easier to understand.

### **Regulatory Flexibility Act**

In accordance with section 3(a) of the Regulatory Flexibility Act (5 U.S.C. 603(a)), the Board must publish an initial regulatory flexibility analysis with this proposed rule. The proposed rule, if adopted, would exempt financial subsidiaries of state nonmember banks from the anti-tying restrictions in section 106 of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. 1972). A description of the reasons for the Board’s decision to issue the proposed rule and a statement of the objectives of, and legal basis for, the proposed rule are contained in the supplementary information provided above.

The proposed rule would apply to all state nonmember banks regardless of their size. The proposed rule would exempt any financial subsidiary of a state nonmember bank (including a small state nonmember bank) from the restrictions of section 106 and, thus, should

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<sup>5</sup> 15 U.S.C. 1 et seq. (Sherman Act); 15 U.S.C. 12 et seq. (Clayton Act).

<sup>6</sup> See 12 U.S.C. 1831w.

<sup>7</sup> As noted above, section 208.73(e) of the Board’s Regulation H currently provides that a financial subsidiary of a state member bank is treated as an affiliate (and not a subsidiary) of the bank for purposes of section 106. 12 CFR 208.73(e). In order to consolidate the regulatory provisions relating to the treatment of financial subsidiaries of state banks under section 106, the Board also is proposing to include in section 225.7 of Regulation Y the provision that states that a financial subsidiary of a state member bank is treated as an affiliate of the bank for purposes of section 106.

<sup>8</sup> Pub. L. No. 106-102, 113 Stat. 1338 (1999), codified at 12 U.S.C. 4809.

reduce the regulatory burden imposed on state nonmember banks with financial subsidiaries. The proposed rule also would equalize the treatment of financial subsidiaries of national and state banks under section 106 and, thus, promotes competitive equality. The Board specifically seeks comment on the likely burden the proposed rule would have on banks, especially small banks.

### **Paperwork Reduction Act**

In accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3506; 5 CFR 1320 Appendix A.1), the Board has reviewed the proposed rule under authority delegated to the Board by the Office of Management and Budget. The proposed rule contains no collections of information pursuant to the Paperwork Reduction Act.

### **List of Subjects in 12 CFR Part 225**

Administrative practice and procedures, Banks, Banking, Federal Reserve System, Holding companies, Reporting and recordkeeping requirements, Securities.

### **Authority and Issuance**

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

### **PART 225 -- BANK HOLDING COMPANIES AND CHANGE IN BANK CONTROL (REGULATION Y)**

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

**Authority:** 12 U.S.C. 1817(j)(13), 1818, 1828(o), 1831i, 1831p-1, 1843(c)(8), 1843(k), 1844(b), 1972(1), 3106, 3108, 3310, 3331-3351, 3907, and 3909; and 15 U.S.C. 6801 and 6805.

2. Section 225.7 is amended as follows:

- a. By revising the introductory sentence of paragraph (b);
- b. By redesignating paragraphs (c) through (e) as paragraphs (d) through (f), respectively; and
- c. By adding a new paragraph (c).

### **§ 225.7 Exceptions to Tying Restrictions**

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(b) Exceptions to statute. Subject to the limitations of paragraph (d) of this section, a bank may-

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(c) Financial subsidiaries of state banks. A financial subsidiary of a state member bank held in accordance with section 9 of the Federal Reserve Act (12 U.S.C. 335) and a financial subsidiary of a state nonmember bank held in accordance with section 46 of the Federal Deposit Insurance Act (12 U.S.C. 1831w) shall be deemed to be a subsidiary of a bank holding company of the bank and an affiliate of the bank, and not a subsidiary of the bank, for purposes of section 106 and this section.

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By order of the Board of Governors of the Federal Reserve System, August 25, 2003.

Jennifer J. Johnson (signed)

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Jennifer J. Johnson  
Secretary of the Board