

FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Parts 332 and 337

Proposed Exemption From Provisions
Prohibiting a Bank From Guaranteeing
or Acting as Surety for the Obligations
of Others

AGENCY: Federal Deposit Insurance Corporation.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Federal Deposit Insurance Corporation ("FDIC") proposes to amend its regulations which prohibit an insured nonmember bank from guaranteeing the obligations of third parties. The amendments are in the form of an exemption and are designed to allow banks to do two things: (1) to issue check guaranty cards, and (2) to sponsor customers in credit card agreements with other banks. A number of banks have asked that the present restrictions exclude check guaranty cards and customer-sponsored credit card accounts.

The proposed amendments would allow banks to enter into such undertakings as long as they meet certain criteria pertaining to safety and soundness. The language of the proposed amendments is broad enough to include arrangements that have similar characteristics, but have been termed differently.

DATE: Comments must be submitted on or before (60 days from publication in the Federal Register.)

ADDRESS: Comments may be mailed to Hoyle L. Robinson, Executive Secretary, Federal Deposit Insurance Corporation, 550 17th St., N.W., Washington, D.C., 20429.

FOR FURTHER INFORMATION CONTACT: Fredric H. Karr, Attorney, Legal Division, Federal Deposit Insurance Corporation, 550 17th St., N.W., Washington, D.C., 20429, (202) 389-4171.

SUPPLEMENTARY INFORMATION: The purpose of these amendments is to allow insured nonmember banks to engage in certain practices which are technically in violation of the FDIC's regulations. The FDIC has in mind two specific practices, although the exemption is broad enough to include other arrangements of a similar nature.

The first practice involves so-called check guaranty card programs. These programs can be created by banks, or else the banks can purchase the program through a marketing agreement with an independent company. Regardless of which program the bank chooses, its characteristics are basically the same. The customer must fill out an application for the card. If the applicant wants to obtain an overdraft option together with the card, he/she must fill out a credit application. This is an option, however, and is not a feature of the check guaranty program itself. In some programs, the card can also be used to operate automatic teller machines which allow the customer to withdraw and/or deposit cash in his/her account.

Although various programs have been developed by different banks, these programs have similar characteristics. The card may or may not have a photograph of the customer. The agreements usually require, however, that the guaranteed check be personalized with the cardholder's name. The check must be from the bank that issues the card. The customer's signature, any date of expiration, any verification instructions, and any dollar amount limit for the checks are printed on the card.

The banks that use the system contend that the card serves only as a form of customer identification. The retailer to whom the card is presented, however, has a legal right to rely on the bank's assurance that the customer has sufficient funds to cover his/her check.

The FDIC is of the opinion that these "guarantees" of customer credit are either prohibited outright by 12 CFR 332.1(d) which enjoins a bank from guaranteeing or becoming a surety upon the obligation of others or, at the very least, are similar in nature to standby letters of credit and are subject to the restrictions of 12 CFR 337.2. These "guarantees", however, represent small risk to the safety and soundness of the bank. The low maximum limits typically imposed by banks on the card make it fairly difficult for a cardholder to write enough checks to amass large amounts of debt. Also, the verification procedure banks elect to impose should minimize the banks' exposure.

The second practice is the sponsorship of a customer in the credit card program offered by another bank. In this type of arrangement, a bank issues a credit card to a customer of the sponsoring bank. The sponsoring bank in turn assumes all the responsibility in case of a default by the cardholder. The sponsoring bank lends its credit rating to its customers while the correspondent bank does the billing and receives the interest. This practice violates 12 CFR 332.1(d).

One of the problems with customer-sponsored credit card accounts is that neither the sponsoring bank nor the issuing bank may have performed a credit investigation of the applicants. Failure to screen an applicant before issuing a card could expose the sponsoring bank to an unnecessarily high degree of risk. The exemption attempts to minimize this exposure by requiring credit checks on each applicant by the sponsoring bank prior to issuance of the guarantee to the card-issuing bank.

The FDIC is aware that both types of practices are in limited use throughout the country, but has not been able to assess what, if any, industry standards apply to their operation. Although the criteria in the exemption are believed necessary for safety and soundness reasons, they may add to the costs of compliance in the case of banks which do not already have similar standards for their programs. While the FDIC believes that most banks with check guaranty or customer-sponsored credit card programs do have similar standards, the question of compliance cost is one on which public comment is desirable. There may be alternate less costly criteria which would be just as effective. There may be no need for certain criteria. The FDIC, therefore, invites comments on these issues.

The FDIC certifies that these amendments will not have a significant economic impact on a substantial number of small entities. Therefore, a regulatory-flexibility analysis is not required. Currently, banks that offer these programs must comply with the disclosure requirements of § 337.2(d). The amendment would exempt banks from these disclosures, thus reducing their costs. Banks that already offer these programs are not required to make or keep new disclosures or records. Banks that decide to offer these services may set up the accounting systems best suited to their needs.

The effects of this amendment on competition will be positive. Small banks which do not have the resources to offer credit cards to their customers will be able to do so through the customer-sponsored credit card account. This will enable them to compete with larger banks that can and do issue credit cards.

Consumers should benefit from the proposed amendment because check guaranty card arrangements will make it easier for them to purchase goods with their checks. The customer-sponsored credit card accounts will allow some bank customers access to credit cards without forcing them to change their other banking relationships.

The FDIC believes that the regulation will not have a significant adverse effect on a substantial number of small entities. This view, however, is based on the nature of the amendment, the assumption that most banks have standards for their programs that are similar to those proposed by the FDIC, and, the limited amount of information available on programs conducted by small banks.

Alternatives to the amendments are (1) to enforce the regulations and force insured nonmember banks to either modify or dismantle their existing programs; (2) to maintain the status quo, allowing at least some nonmember banks to continue practices that do not conform to FDIC regulations; or (3) to revoke Part 332 in its entirety.

The first alternative is costly and impractical in view of the widespread use of these arrangements and the limited risks involved. The second alternative is not acceptable because both types of undertakings fall within the regulatory prohibitions.

The third alternative on which the FDIC solicits public comment is whether Part 332 is necessary at all and hence whether it should be revoked. If this particular proposal is adopted without revoking Part 332, it will mean that there will be other exceptions added to Part 332, and the issue is then raised as to whether the exceptions are really encompassing the rule. Another reason supporting reexamination of Part 332 is the general atmosphere in the 1980s of the deregulation of banking. Part 332 generally prohibits State nonmember insured banks from engaging in a surety business, insuring the fidelity of others, engaging in insuring, guaranteeing or certifying titles to real estate, or guaranteeing or becoming surety upon the obligations of others.

The Board specifically invites comment on whether the prohibition of activities of this kind would best be left to the State laws that prescribe the powers of State-chartered banks. Additionally, comment is invited on why or why not the enumerated powers should be found to be inconsistent with the purposes of the Federal Deposit Insurance Act.

List of subjects in 12 CFR Part 332: Banks, banking; Credit; Federal Deposit Insurance Corporation; State nonmember banks.

List of subjects in 12 CFR Part 337: Banks, banking; Credit; Federal Deposit Insurance Corporation; Securities; State nonmember banks.

PART 332 - Powers Inconsistent
With Purposes of Federal
Deposit Insurance Law

12 CFR Part 332 is amended as follows:

1. The authority citation for Part 332 reads as follows:

Authority: Secs. 6, 9, 64 Stat. 876, 881; 12 U.S.C. 1816, 1819.

2. A new § 332.3 is added to read as follows:

§ 332.3 Exemption.

Check guaranty card programs, customer-sponsored credit card programs, and similar arrangements in which a bank undertakes to guarantee the obligations of individuals who are retail banking deposit customers are exempted from § 332.1 of this subchapter: Provided, however, that the bank performs a credit check on the individual before undertaking to guarantee his/her obligations and that any such arrangement to which a bank's principal shareholders, directors, or executive officers are a party be in compliance with Federal Reserve Regulation O (12 CFR Part 215).

PART 337 - Unsafe and Unsound
Banking Practices

12 CFR Part 337 is amended as follows:

3. The authority citation for Part 337 reads as follows:

Authority: Sec. 9, 64 Stat. 881-882, 12 U.S.C. 1819; Sec. 18(j)(2), 92 Stat. 3664, 12 U.S.C. 1828(j)(2); Sec. 422, 96 Stat. 1469, Pub. L. 97-320.

4. A new § 337.5 is added to read as follows:

§ 337.5 Exemption.

Check guaranty card programs, customer-sponsored credit card programs, and similar arrangements in which a bank undertakes to guarantee the obligations of individuals who are retail banking deposit customers are exempted from § 337.2. Provided, however, that the bank performs a credit check of the individual before undertaking to guarantee his/her obligations and that any such arrangement to which a bank's principal shareholders, directors, or executive officers are a party be in compliance with Federal Reserve Regulation O (12 CFR Part 215).

§§ 337.6 - 337.9 [RESERVED]

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By Order of the Board of Directors, *August 13, 1984.*

FEDERAL DEPOSIT INSURANCE CORPORATION



Hoyle L. Robinson
Executive Secretary