Today's Credit Markets, Relationship Banking, and Tying

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I. Introduction.

Considerable attention recently has focused on the practice of "relationship banking" widely employed in the financial services industry, and on the issue of possible "tying" by banks. Most commercial banks have practices in place to evaluate the profitability of large corporate customers on the basis of their business relationship. Banks generally offer customers the choice of an array of products and services the customer may use to meet the bank's internal profitability standards. In certain instances, a bank may make a determination to exit a relationship with a customer who is unable to provide the bank sufficient revenues for the risks undertaken. Concerns have been raised over whether such relationship banking practices are consistent with federal anti-tying law, which generally prohibits banks from conditioning the availability or price of one product on the purchase of another product, with various exceptions.

Several recent reviews initiated by Congress, regulatory organizations, and interested industry participants relate to tying matters. Last year, the Office of the Comptroller of the Currency ("OCC") and the Board of Governors of the Federal Reserve System ("Board") responded jointly to two requests from Congressman Dingell questioning whether banks are tying the availability or price of credit to investment banking services.[1] At about the same time, the General Accounting Office ("GAO"), at the request of Congressman Dingell, initiated a review of banks' tying practices. The GAO expects to issue a report in October 2003, which also will update an earlier report concerning tying practices by banks.[2] More recently, Congressmen Oxley and Frank made a similar request to the GAO to update the earlier report and to analyze various issues relating to section 106(b) of the Bank Holding Company Act Amendments of 1970.

Further, the National Association of Securities Dealers, Inc. ("NASD") has been investigating broker-dealers affiliated with commercial banks and seeking to determine whether tying of investment banking services and commercial credit has occurred in possible violation of NASD rules.[3] During the last year, the OCC and Board also have conducted a joint review of tying practices at large banking organizations. In March 2003, the Association for Financial Professionals ("AFP") released results from a survey of financial professionals generally indicating that commercial banks frequently combine access to credit with the purchase of other financial services, although the survey results did not distinguish whether the lending was from an affiliate or the bank itself.[4]

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[1] Letters from John D. Hawke, Jr., Comptroller of the Currency, and Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System, dated August 13, 2002, and October 16, 2002, respectively ("Dingell letter").

[2] U.S. General Accounting Office, Report to Congressional Committees, *Bank Oversight: Few Cases of Tying Have Been Detected,* GAO/GGD-97-58 (May 1997).

[3] Rule 2110, for example, requires NASD members to conduct business in accordance with "just and equitable rules of trade." *See* NASD "Special Notice to Members," *Prohibition of Certain Bank Tying Arrangements* (Sept. 2002).

[4] *See* Ass'n for Financial Professionals, *Credit Access Survey: Linking Corporate Credit to the Awarding of Other Financial Services* (Report of Survey Results) (Mar. 2003).

In Part II of this paper we describe relationship banking practices prevalent in the markets. Part III provides an economic analysis of relationship banking and concludes that relationship banking is more likely the result of cost savings, not anti-competitive tying. In Part IV, we focus on the federal anti-tying law applicable to banks as established under section 106(b) of the Bank Holding Company Act Amendments of 1970, and provide an analysis of the legislative history and other legal standards to conclude that the relationship banking practices under review are consistent with the relevant legal framework on tying. Lastly, in Part V, we provide recommendations for clarifying the tying requirements applicable to the relationship banking practices in today's credit markets.

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II. Description of Relationship Banking Practices.

Relationship business practices, that is, building on existing business relationships in order to enhance the profitability of those relationships for the relevant business, have been an integral component of the success of capitalist economies. From a sales and marketing perspective, no service-oriented business can survive without continually evaluating who its customers are, the types of products they require and purchase, and their overall profitability to the company. Accordingly, common business practices include developing and pursuing customers whose relationship generates or will potentially generate significant revenues for the corporation.

Relationship banking practices represent just one type of relationship business practice. The availability of one type of product may provide the bank an opportunity to cross-market and sell customers other types of financial services. A customer-initiated request may prompt a bank to offer multiple products and services. Throughout the decades, banks often have made business decisions on the basis of the customer's overall business relationship with the banking organization.[5] Thus, relationship business is a well-established and long-practiced approach to conducting business.

The removal of earlier legal and regulatory barriers to certain bank activities has resulted in banks increasingly generating and depending upon revenue from a greater variety of products and services than was historically the case. Moreover, in recent years, the financial services markets within which banks operate have become increasingly competitive with investment banking firms and other nonbank financial services providers offering bank-like products to their customers. This has led banking organizations to seek to maximize the profitability of their existing customer relationships by enhancing both the quality and the number of the products and services they provide to each customer.

A key factor in the bank's decision to continue providing credit often is the profitability of the total customer relationship. In other words, a bank will evaluate a customer's overall relationship by measuring returns based on all products and services provided to that particular customer by the bank, as well as by its affiliates. In some cases, banks may find the profitability of the total customer relationship does not meet internal profitability standards.[6] To meet profitability expectations, banks may ask existing customers to choose from an array of products and services offered by the banking organization, including those typically referred to as

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[5] *See, e.g.,* American Banker 150th Anniversary, A Commemorative Edition, *Guidelines for Bankers, 1830s Style* (originally published circa 1837) ("don't open a new account for anyone unless you know him personally… you can best attract new accounts through public knowledge that you treat your old customers best"); American Banker, *Citibank's New Check Fee Schedule to Boost 'Relationship Banking,'* (Sept. 1980); American Banker, *Biz Owners Want to See Bankers* (Mar. 26, 2003) ("what relationship banking is all about").

[6] As the OCC and Fed explained to Congressman Dingell, banking organizations may establish internal hurdle rates of return as part of their internal capital allocation or risk-pricing methodologies. These internal hurdle rates are determined by both market driven and institution-specific characteristics. One critical component is the corporate return on equity required by shareholders. Often internal profitability goals may be achieved by the execution of other transactions or the provision of other services that generate returns in excess of the internal hurdle rate. *See* Dingell Letter (Oct. 16, 2002), Appendix, at 6.

“traditional bank products,” such as loan and deposit products, and also non-traditional products and services, such as investment banking services. However, this does not mean that the bank’s practices impermissibly condition the purchase of a traditional product or vary the price based on the customer purchasing a non-traditional product. Rather, in those cases, the customer has the option to choose if, and how, to enhance the revenues it represents for the bank to meet the institution’s legitimate business expectations relating to profitability.

As a prudent business practice, banks take into account overall relationship profitability in deciding which customer relationships to pursue. Consequently, banks may charge higher spreads on credit facilities, tighten loan terms and conditions, and, in some cases, terminate established credit lines when overall customer relationships do not return sufficient revenues for the risks undertaken. In some cases, the bank may make a business decision to exit the relationship entirely.

Banks have training and compliance programs of various types to prevent inappropriate tying practices arising from relationship banking or other practices. Effective training programs educate bank staff on the requirements of the anti-tying laws, provide examples of prohibited practices and, sensitize employees to the concerns raised by tying. Among others, measures banks may implement include face-to-face training programs, audit and compliance programs reviewed by management, routine monitoring and updating of policies and procedures, review of customer files, and a response process to address any customer allegations of prohibited tying arrangements. Relationship banking and tying are two distinct concepts. This paper describes certain aspects of each concept and analyzes the relevance of one to the other from an economic and legal perspective.

III. Economic and Market Analysis of Relationship Banking.

Over the last fifteen years, regulatory barriers to entry into investment banking activities by banking companies have gradually been eliminated. With these restrictions lifted, banking companies have sought to increase their share of securities underwriting and related products and services. Some observers assert that banks have taken advantage of their ability to extend credit in order to build their affiliates’ investment banking market share. Specifically, some have alleged that banks have tied the pricing and availability of business credit to the purchase of investment banking services from bank affiliates.

Tying exists when the sale or price of one product is made conditional upon the purchaser also buying a secondary product. Generally, the primary product is one where the supplier exercises some degree of market power and barriers to entry exist in the market. It is this market power in the primary product that requires the customer to purchase both products from a single source, ultimately driving specialized competitors from the secondary market.[7] Barriers to entry in the primary market effectively keep competitors out of both markets. Since banking companies traditionally have been the dominant suppliers of commercial credit, the commercial loan is

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[7] In the industrial organization literature, this strategy is called the “leverage” motive for tying and refers to leveraging market power in the primary market into market power in the secondary market.

typically viewed as the primary product in discussions of bank tying and the secondary product is some sort of investment banking service, e.g., underwriting a debt or equity issue.

In spite of the allegations, there is little direct evidence on tying by banks.[8] One reason for the lack of direct evidence is the prohibition on tying by banks dating from 1970. Nonetheless, it is possible to look for indirect evidence of tying by analyzing the competitiveness of the commercial lending market. Also, investigating the investment banking market for signs that specialized investment banks are at a disadvantage might reveal indirect evidence on tying, since the main aim of a tying strategy is to ultimately drive specialized competitors from the market.

In all cases, it is important to note that allegations of anti-competitive tying require more than casual evidence that banks offer, and customers purchase, "bundles" of related products from a single supplier. The cost advantages of relationship banking discussed below provide a number of reasons why firms would sell and customers would want to buy multiple products, reasons that have nothing to do with tying in the anti-competitive sense.

A. Banks Do Not Possess the Market Power to Engage in Anti-Competitive Tying.

There is little evidence that banks have market power in the commercial loan market, especially for larger credits.[9] Larger bank borrowers are the customer class most likely to have a need for investment banking services. One indicator of the competitiveness of the market for larger commercial credits is that it is typically ignored in antitrust analysis of banking mergers. The reason why it is ignored is because it is assumed to be national in geographic scope, with numerous actual and potential competitors offering credit substitutes.

In addition to market power, entry and exit must be costly for a leverage strategy to succeed. The existence of such barriers would allow tying firms to enjoy the fruits of any market power they obtain. The Financial Modernization Act of 1999, also known as the Gramm-Leach-Bliley Act ("GLBA"), removed most of the regulatory barriers to entry into investment banking by banking companies <u>and</u> investment banking companies' entry into banking. Thus, specialized investment banking companies that perceive a lending-related competitive disadvantage now have the option to purchase a commercial bank. While specialized investment banks have not generally entered the lending market through the acquisition of a bank to date, there is evidence that they are competing for loan customers.

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[8] *See* U.S. General Accounting Office, Report to Congressional Committees, *Bank Oversight: Few Cases of Tying Have Been Detected*, GAO/GGD-97-58 (May 1997). Only a single academic study looked directly at the bank tying issue. This is contained in B. Shull, *Tying and Other Conditional Agreements under Section 106 of the Bank Holding Act: A Reconsideration,* Antitrust Bulletin (Winter 1993). The focus of his study is the analysis of private court cases brought by plaintiffs alleging tying violations by banks. In his analysis, Shull did not find a single case where the tied service was a non-traditional banking product such as securities underwriting. None of the cases provided any evidence of injury to competition in the tied market. He concludes that there is no evidence that tying restrictions have had the intended procompetitive effects and should be reevaluated by Congress with a view toward substantial revision or repeal.

[9] For recent anecdotal evidence on banks' lack of market power in commercial lending see J. Reosti,. *New Wave of Business Refis: Banks Play Defense,* American Banker (May 13, 2003).

For example, a number of recent articles in the financial press detail the lending activities of specialized investment banking companies.[10] In addition, recent data from the banking agencies' Shared National Credits Program ("SNC") also document the competitiveness of this loan market and the growing role of nonbank lenders to large corporate borrowers.[11]

Shared national credits allow participants to compete more effectively with public debt markets for corporate borrowers and provides a cost-effective method for participants to achieve diversification.[12] The nonbank share of SNC credits *grew* from 7 percent in 2000 to 11.3 percent in 2003. The increase in nonbanks' share mirrored the *decline* in banks' share over the same period. All told, of the 3,198 lenders holding credits reviewed as part of the SNC program in 2003, 892 or nearly 30 percent were nonbanks. The bank agent for the largest number of SNC reviewed loans accounted for only 18 percent of the loans in the SNC loan review; the top five banks' loans accounted for only 51 percent of the loans in the SNC program, and the top ten banks accounted for 62 percent of the SNC reviewed credits. These statistics reflect a competitive credit market where it would be very difficult for one bank to effectively tie the availability of its loans to the condition that a customer take other products from the bank or its affiliates.

Substitutes for bank credit also prevent banks from acquiring market power. Borrowers increasingly have the option of tapping public markets for funds, expanding the list of substitutes for bank credit. A recent paper by Gilson and Warner (1997) finds that the most frequently cited reason for junk bond issuance is to pay down bank debt.[13] Federal Reserve Flow of Funds data also illustrates the competitive impact of the growth of substitutes for bank loans.[14] For example, in 1995, bank loans only accounted for about 10 percent of the outstanding liabilities of

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[10] *See* N. Ring, *Morgan Stanley Profit Report Shows Focus on Lending to Clients,* American Banker (June 22, 2001); A. Schmelkin, *Morgan Stanley Will Use its Balance Sheet Carefully,* American Banker (April 25, 2002); *Lehman, Merrill New Syndicated Forces,* American Banker (July 25, 2001).

[11] A shared national credit is a syndicated loan or formal loan commitment to a single borrower extended by an institution supervised by the federal banking agencies with an original amount of $20 million or more and which is jointly underwritten by three or more unaffiliated institutions. An agent bank typically leads the loan syndicate, initially underwrites the credit, and finds participants willing to purchase shares of the credit. The Federal Deposit Insurance Corporation, the Federal Reserve Board, and the Office of the Comptroller of the Currency jointly administer the SNC Program to ensure consistency and reduce duplication among the banking agencies in the classification of large syndicated loans.

The syndicated loan market combines features of both commercial and investment banking. For instance, like other bank loans, syndicated loans can be of any maturity and provide the flexibility of changing contract features during the life of the loan. Like public debt, syndicated loans are typically longer term and are rarely restructured.

[12] J. Jones, W. Lang, and P. Nigro, *Recent Trends in Bank Loan Syndications: Evidence for 1995 to 1999,* Comptroller of the Currency Economic and Policy Analysis Working Paper 2000-10 (Dec. 2000).

[13] S. Gilson and J. Warner, *Junk Bonds, Bank Debt, and Financing Corporate Growth* (unpublished manuscript) (Oct. 1997).

[14] All of the Flow of Funds data used here is drawn from Board of Governors of the Federal Reserve System. Flow of Funds Accounts for the United States 1995 – 2002 (March 6, 2003).

all nonfarm nonfinancial corporate businesses and corporate bonds accounted for 22.4 percent. By 2002, the bank loan share had fallen to 7.2 percent, while the corporate bond share of liabilities rose to 25.9 percent. Thus, larger corporate entities clearly have been substituting other forms of debt for bank loans.[15]

Commercial banks also do not appear to have gained market power in underwriting and other investment banking services. A recent paper by Chaplinsky and Erwin (2001) finds that commercial banks had an aggregate share of equity underwriting of 26 percent in 2000.[16] Roten and Mullineaux (2002) report an aggregate bank share of debt underwriting of roughly 28 percent in 1998.[17] In both of these markets, the dominant firms continue to be specialized investment banks.

B. The Economic Performance of Diversified Commercial Banks Does Not Show Evidence of Tying.

If the combination of commercial and investment banking generates benefits for banks due to anti-competitive tying or any other reason, it should be evident in improved performance. The evidence on this issue is somewhat mixed, but taken together it does not show that, to date, banks have realized significant benefits from their entry into underwriting.

On the anecdotal side, for example, there have been several recent instances of bank holding companies reversing past decisions to acquire investment banking units.[18] In a number of "event studies" that examine the effects of removing legal restrictions on bank involvement in securities underwriting, there are few instances of significant positive returns (indicating that the market expects higher future returns) to holding companies with securities subsidiaries when restrictions on their activities were relaxed in the U.S.[19] In fact, in most cases, these companies

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[15] Other Flow of Funds data document a shift away from shorter term loans to other longer term liabilities by businesses over this same time period. For example, loans and short term paper account for roughly 15 percent of the total liabilities of nonfarm nonfinancial corporations in 2002, down from 20.2 percent in 1995. The ratio of short term debt to total credit market debt also declined from 41.7 percent to 31.8 percent during this time period. Admittedly some of this decline could be temporary and reflect macroeconomic conditions.

[16] S. Chaplinsky and G. Erwin, *Commercial Banks as Equity Underwriters,* (unpublished manuscript) (Dec. 2001).

[17] I. Roten and D. Mullineaux, *Debt Underwriting by Commercial Bank-Affiliated Firms and Investment Banks: More Evidence,* Journal of Banking and Finance (2002).

[18] See R. Julavits, *In Focus: Rethinking the Business Case Behind Some of GLB's Changes,* American Banker (Nov. 8, 2002); L. Moyer, *In Brief: No Sale: Fleet Closing Robertson Stephens,* American Banker (July 15, 2002); J. Reosti, *Cullen/Frost's About-Face on Investment Banking,* American Banker (Aug. 13, 2002); L. Mandaro, *A Painless Extraction: A Closer Look at USB – Piper,* American Banker (Feb. 21, 2003).

[19] Event studies estimate the economic or wealth effect of some "event" (e.g. the passage of GLBA) by focusing on the "abnormal" stock returns to various groups of entities presumably affected by the event. Abnormal returns are calculated by subtracting estimated "normal" returns from returns actually observed around the time at which the event occurs. Positive returns for some group indicate that the market expects this group to benefit from the event and vice versa.

exhibited negative significant returns around the dates when bank securities powers expanded.[20] This suggests that the market expected closer integration of lending and underwriting to result in net costs for diversified banks, which obviously is not consistent with expected benefits for banks stemming from reductions in competition in either lending or underwriting due to tying or any other reason.

Evidence from other empirical studies generally shows that bank entry into securities underwriting has enhanced competition in underwriting, especially benefiting smaller, lower quality firms, and that diversified banks have not been able to dominate these markets by virtue of tying or any other reason. For example, Gande, Puri and Saunders (1999) investigate the effects of commercial bank entry into the corporate debt underwriting market.[21] They find that between 1991 and 1996, the bank share of the volume of debt issues underwritten rose from 4.4 percent to 16.3 percent and their share of the number of issues rose from 5.8 percent to 20.4 percent. They also show that bank entry into underwriting had a significant, negative impact on gross underwriting spreads, i.e., bank entry lowered the fees for companies issuing the debt.[22] This effect is evident for both investment grade and non-investment grade issues, but it is much larger for the latter. A similar negative effect is evident for smaller relative to larger issues.[23] The authors also present data on concentration trends in the debt underwriting market over the 1985-1996 period. They report both five-firm concentration ratios and Herfindahl-Hirschman Index (HHI) measures (which are conventional indicators of market competition) for all corporate debt and for two rating classes of securities (Caa-Ba3, Baa1-Aaa). All of these measures show a decline in concentration over the period, with a pronounced downward trend beginning in 1991. The decline is the sharpest for the lower-rated issues. Taken together, these results suggest that bank entry into debt underwriting, at least over this period, has increased competition in this market.

A more recent study by Roten and Mullineaux (2002) updates the study by Gande, et al. and explicitly tests how the existence of a bank lending relationship affects gross underwriting spreads and yields. They do not find any effects associated with the existence of a prior lending relationship. That is, securities issuers do not appear to realize significant benefits from having securities underwritten by their lender, although the reason for this result is not clear. This finding also implies that competition from diversified banks has not put non-lending specialized

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[20] *See* K. Carow and E. Kane, *Event Study Evidence on the Value of Relaxing Long-Standing Regulatory Restraints on Banks,* Quarterly Review of Economics and Finance 33 No. 2 (Summer 2002); K. Carow and R. Herron, *Capital Market Reactions to the Passage of the Financial Services Modernization Act of 1999,* Quarterly Review of Economics and Finance 33 No.2 (Summer 2002); R. Narayanan, R.Rangan, and S. Sundaram, *Welfare Effects of Expanding Banking Organization Opportunities in the Securities Area,* Quarterly Review of Economics and Finance 33 No.2 (Summer 2002).

[21] A. Gande, M. Puri, and A. Saunders, *Bank Entry, Competition, and the Market for Corporate Security Underwriting,* 2 Journal of Financial Economics 54 (1999).

[22] Gross underwriting spreads are measures of fees paid to the underwriter and are defined as the difference between the offered amount and the proceeds to the issuer expressed as a percentage of the offered amount.

[23] They find similar effects for post-transaction yield spreads. The ex ante yield spread is the difference between an ex ante debt yield of a given issuer and the ex ante yield of a U.S. Treasury security of comparable maturity.

investment banks at a competitive disadvantage. They also report that the commercial bank aggregate share of debt underwriting stood at 28 percent in 1998, again a relatively modest level.

Another study of the effect of bank entry into securities markets focuses on the market for industrial revenue bonds.[24] The findings of this study by Saunders and Stover (2001) are interesting because banks are permitted to act both as a credit guarantor and underwriter. Thus, one can see the extent to which they play both roles where tying might become an issue. Their sample consists of 1003 debt issues. Of these, 665 were not backed by a letter of credit and were underwritten by investment banks, 145 were backed by bank letters of credit and were underwritten by investment banks, 82 had bank letters of credit and were bank underwritten, and 110 were underwritten by commercial banks without a letter of credit. Of the 82 issues that were commercial bank underwritten and backed by a letter of credit, just 36 had the same commercial bank providing both. Thus, in only very few cases did the same bank act in both capacities. This finding suggests very few instances of even potential tying.

A study by Chaplinsky and Erwin (2001) focuses on changes in the share of equity underwriting by commercial banks between 1990 and 2000. They find that the commercial bank aggregate share of equity underwriting was roughly 26 percent at the end of this period. They also find that the aggregate commercial bank share of equity underwriting declined each year after 1996 and had fallen 9 percentage points by the end of 2000. But they mainly focus on the reasons for changes in banks' market share. Their analysis reveals that banks obtained much of their equity underwriting market share through acquisition, and that banks typically are not able to expand market share post-merger. In fact, they find that in 62 percent of bank acquisitions of investment banking affiliates, combined market share was constant or declined after the merger. Moreover, they find that the average market share for the combined entity (bank plus investment banking affiliate) falls from 1.5 percent three years prior to the merger to 1.1 percent post-merger and the average decline in market share is statistically significant.

A recent paper by Mullineaux (2003) considers whether tying by commercial banks makes economic sense.[25] He argues that while an economic rationale exists for banking organizations to assess the value of relationships and bundle services in the highly competitive lending market, the lack of market power among competing banks in this market does not permit tying. He refers to data from the syndicated loan market to conclude that the nature of this market practically assures a competitive outcome. Furthermore, he suggests that a bank would not be likely to pursue a tying strategy because it is more apt to destroy rather than enhance organizational value. He concludes that there appears to be no economic logic to support a claim that commercial banks are illegally tying commercial lending activities to the provision of investment banking services.

Mullineaux also evaluates allegations that differences in the relative interest rates on loans versus bonds provide evidence of tying.[26] He points out that several studies identify significant

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[24] A. Saunders and R. Stover, *Commercial Bank Underwriting of Credit-Enhanced Bonds: Are there Benefits to the Issuer?* (unpublished manuscript) (2001).

[25] Donald J. Mullineaux, *Tying and Subsidized Loans: A Doubtful Problem,* (manuscript) (May 2003).

[26] He makes similar arguments regarding simple comparisons between commercial loans and credit default swaps.

differences in loan and bond characteristics, such as collateral, seniority, maturity, covenants, and ease of restructuring, that affect pricing. He adds that because of the many differences between loans and bonds, any rational borrower shops for credit based on the total package of terms rather than just the price of the credit. He dismisses the claims of tying in the press by pointing out that because of the many highlighted differences between loans and bonds, simple comparisons of rates on loans with rates on bonds cannot produce valid inferences about tying. He concludes that simple comparisons between loan and bond rates provide no evidence of tying.

C. Specialized Investment Banking Companies Can Compete with Diversified Banking Organizations.

The available evidence also suggests that investment banks can effectively compete with banks despite any disadvantage stemming from their lesser capability or willingness to make commercial loans. For example, a recent article in the financial press details the debt underwriting success of two specialized investment banks that choose not to offer commercial loans[27]. This is suggestive evidence that commercial banks have not been able to use any lending advantage to foreclose the debt underwriting market. The structural data on market share trends in underwriting cited above also show that while commercial banks have made competitive inroads, specialized investment banks continue to dominate most investment banking activities. Vander Vennet (2002) also shows evidence from Europe that more specialized financial intermediaries continue to co-exist with financial conglomerates.

In the event studies cited above, the authors also typically examine specialized investment banking companies around dates at which restrictions on commercial bank underwriting activities were removed. If the market expected broader bank securities powers to materially reduce the future profitability of specialized securities firms, then negative significant returns for the investment banking companies should be observed. This sort of result is not typically in evidence. In most cases, the returns are insignificant and in several cases, positive significant returns are observed for specialized investment banking companies. For example, this is the finding in Carow and Herron (2002) for announcement dates leading up to the passage of the Gramm-Leach-Bliley Act.

Some of the other empirical studies previously cited provide insight on possible reasons why specialized investment banks have been able to hold their own. For example, Roten and Mullineaux (2002) do not find evidence that customers realize significant benefits when their lending bank also underwrites their debt securities. Saunders and Stover (2002) find that customers rarely choose the same bank to both guarantee and underwrite industrial revenue bonds. They also find that the issues underwritten by traditional investment banks (with or without credit guarantees) are most favorably received by the market, which suggests there is no competitive disadvantage for the more specialized intermediaries. Similarly, Narayan, Rangan, and Rangan (2001) find that few bank borrowers (around 4 percent) choose to have equity offerings underwritten by their lending bank. They attribute their result to investor concerns

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[27] A. Schmelkin, *Preferred Issues: Lehman, Bear Score Without Lending Clout,* American Banker (June 24, 2002).

about potential conflicts of interest when a diversified financial firm acts in both capacities. In fact, they find that banks attempt to mitigate these concerns by co-managing these securities issues with high reputation non-lending underwriters.

D. Relationship Banking Can Result in Cost Savings for Both Banks and Their Customers.

While banking organizations have made only limited inroads into investment banking, the limited successes they have had is most likely due to cost savings. The key role assumed by financial intermediaries involved in lending or underwriting is bridging the information gap between risky borrowers and cautious savers. Borrowers generally have a comprehensive understanding of the strengths and weaknesses of the endeavor they are undertaking. But savers lack the incentives and ability to evaluate complex investments and monitor borrowers efficiently. This is especially true in the case of riskier borrowers such as small start-up firms, which may have financial information that is particularly difficult to interpret.

In order to bridge the information gap, lenders and underwriters must invest in acquiring firm-specific information to assess creditworthiness or certify and monitor a securities issuance. Potential borrowers also incur expenses in selecting a financial intermediary and transmitting to that firm the required, and possibly proprietary, information. Since this information can often be reliable and useful for a significant period of time, repeat dealings in the same product (e.g., loans) or in multiple related products (e.g., loans and securities underwriting) can generate savings for financial intermediaries and their customers. In the case of multiple related products, the acquired information is also a potential source of economies of scope for the intermediary, creating an incentive for a single firm to engage in both lending and underwriting.[28]

Borrowers also can realize cost savings from relationship banking. By bundling their purchases and dealing with a single supplier, borrowers avoid the costs of seeking out and conveying relevant information to additional intermediaries.[29] The bundling of multiple banking products by customers provides greater income generating capacity for the diversified firm.

Relationships between banks and borrowers also may have positive effects on the reputations of both parties. For example, the fact that an intermediary has extended or renewed a loan provides a positive signal to the market about the creditworthiness of the borrower. Positive signals, in turn, make it easier for borrowers to tap alternative sources of funds.[30] Similarly, increases in lending and underwriting market share enhance the reputation of the financial intermediary,

[28] In general, scope economies exist when the costs incurred by a firm producing two different goods are lower than the combined costs of two specialized firms producing each good separately.

[29] Recent instances of customer requests for the bundling of banking and underwriting services are presented in J. Creswell, *Banking's Not-So-Secret Weapon,* Fortune (Oct. 14, 2002).

[30] A considerable number of studies have shown that the announcement of a lending relationship results in increases in firm value for borrowing firms.

which may help the intermediary acquire new business. The intermediary's reputation also influences the benefits that the underwriter's certification provides to the customer.[31]

There is, however, one potential marketing disadvantage faced by financial intermediaries that offer packages of multiple products and services to borrowers not faced by specialized firms. That is a possible perception by the investing public, despite legal requirements to the contrary, that an intermediary might withhold adverse private information gained in loan underwriting to benefit themselves and their borrowers to the detriment of investors in a securities issue.[32]

If investors were in fact concerned with such conflicts of interest, one would expect investors to purchase the securities of issuers that also have a lending relationship with the underwriter only at some discount. Narayanan, Rangan, and Rangan (2001) examine this question and find that unless steps are taken to mitigate the possible perception of conflicts of interest, bank underwritten securities where the bank also has a lending relationship with the issuer suffer a four percent under pricing compared to comparable investment bank underwritten issues.[33] They do not find any such discount where the bank does not have a lending relationship with the issuer. They also do not find a discount when the bank serves as a co-manager of the issue with a high reputation independent underwriter (as opposed to lead manager) and that the main determinant of whether a bank assumes a co-manager role in the underwriting syndicate is the presence of a lending relationship. They conclude that banks (or their customers) choose the co-manager role as a way of credibly committing to the market that they are not taking advantage of private information.[34]

IV. Analysis of the Anti-Tying Legal Framework Applicable to Relationship Banking.

The relationship banking practices of national banks as discussed in this paper are consistent with, and permissible under, the anti-tying legal framework. Congress enacted the prohibitions on certain bank tying arrangements as a separate section of the Bank Holding Company Act Amendments of 1970 (the "BHCA Amendments").[35] The legislation brought one-bank holding

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[31] So, for example, an underwriter with a better reputation should be able to sell a given issuer's securities at a lower ex ante yield than a less reputable underwriter could.

[32] For additional examples and an analysis of potential conflicts of interest, see G. Benston, *The Separation of Commercial and Investment Banking* 205-211 (1990).

[33] R. Narayanan, K. Rangan, and N. Rangan, *Commercial Bank Underwriting: Conflict of Interest and Credible Commitment* (unpublished manuscript) (2001).

[34] It is important to note, that while Narayanan, Rangan, and Rangan (2001) provides some evidence that investors may perceive a conflict of interest when an underwriter also has a lending relationship with an issuer, they do not present any evidence—nor do they even discuss—that bank securities underwriters misuse private information gained from a lending relationship.

[35] Pub. L. No. 91-607, 84 Stat. 1760 (Dec. 31, 1970). Legislative history reflects at that time a fear existed of creating giant "conglomerate" cartels centered around large banking institutions. *See* Statement of President Nixon (Mar. 24, 1969) ("disturbing trend…erosion of the traditional separation of powers between the suppliers of money—the banks—and the users of money—commerce and industry").

companies under coverage of the Bank Holding Company Act of 1956 and established the appropriate standards for bank holding companies conducting nonbanking activities. Inextricably intertwined with the overall effort were companion provisions that specifically addressed Congressional concerns relating to improper bank tie-in arrangements. Those provisions became section 106 in the final bill, and are codified at 12 U.S.C. § 1972.

A. Relationship Banking is Permissible under the Plain Language of Section 106.

By enacting section 106, Congress supplemented general antitrust principles prohibiting anti-competitive tying arrangements in the field of commercial banking.[36] In general, a "tying" arrangement is an agreement by one party to sell one product only on the condition that the buyer also purchases a different product.[37] Not all so-called "tying" arrangements are illegal. The thrust of federal antitrust law is to prohibit tying arrangements when the arrangement enables a business entity with sufficient power in one market to coerce purchasers to accept products in other markets and thereby lessen competition.[38] Typically, a federal antitrust illegal tying claim involves a showing of five key elements: (1) two separate products, a tying or "desirable" product, and a tied or "undesirable" product; (2) the buyer was forced to buy the tied product to get the tying product; (3) the seller possessed sufficient economic power in the tying product market to coerce the buyer's acceptance of the tied product; (4) an anti-competitive effect in the tied product market; and (5) the involvement of a not insubstantial amount of interstate commerce in the tied product market.[39]

Prior to enactment of section 106, there was some concern that federal antitrust law did not reach tying involving credit. However, overlapping with the Congressional consideration of the anti-tying legislation, the Supreme Court handed down the *Fortner* decision, which clarified that antitrust standards applicable to other goods and services were equally applicable to credit.[40]

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[36] *See, e.g., Davis v. First Nat'l Bank*, 868 F.2d 206, 208 (7th Cir.), *cert. denied*, 493 U.S. 816 (1989); *Parsons Steel, Inc. v. First Alabama Bank*, 679 F.2d 242, 245 (11th Cir. 1982), *aff'd on other grounds,* 747 F.2d 1367 (1984), *rev'd on other grounds,* 474 U.S. 518 (1986).

[37] Cross-marketing and cross-selling, for example, whether suggestive or aggressive, are part of the nature of ordinary business dealings and do not, in and of themselves, represent a violation of section 106. The more difficult situation is when actions go beyond cross-marketing and cross-selling and the bank imposes a condition or requirement indicating that the bank will not provide the customer the desired product unless the customer obtains another product from the bank or its affiliates. Those situations may violate section 106 and require a careful examination of the specific facts and circumstances pertinent to the transaction.

[38] *See Davis*, 868 F.2d at 208. The general antitrust statutes each contain a provision prohibiting certain tying arrangements. See provisions under the Sherman Act (15 U.S.C. § 1 et seq.), the Clayton Act (15 U.S.C. § 12 et seq.), and the Federal Trade Commission Act (15 U.S.C. § 45 et seq.).

[39] *See, e.g., Integon Life Ins. Corp. v. Browning,* 989 F.2d 1143, 1150 (11th Cir. 1993); *see also Jefferson Parish Hosp. Dist. No. 2 v. Hyde,* 466 U.S. 2 (1984).

[40] *Fortner Enterprises v. U.S. Steel Corp.,* 394 U.S. 495, 508-09 (1969).

The statutory language of section 106(b) specifically prohibits certain forms of product tying by banks. As codified at 12 U.S.C. § 1972, the statute in part provides:

> (1) A bank shall not in any manner extend credit, lease or sell property of any kind, or furnish any service, or fix or vary the consideration for any of the foregoing, on the condition or requirement—
>
> > (A) That the customer shall obtain some additional credit, property, or service from such bank other than a loan, discount, deposit, or trust service;
> >
> > (B) That the customer shall obtain some additional credit, property, or service from a bank holding company of such bank, or from any other subsidiary of such bank holding company;

The basic prohibition in subsection (1)(A) thus prohibits a bank from extending credit, leasing or selling property of any kind, or furnishing any service, or fixing or varying the consideration for any of these financial services, on the "condition or requirement" that the customer obtain some additional credit, property, or service from the bank. For example, a bank may not condition the availability of credit on a customer purchasing the bank's life insurance products.

The statute also expressly provides a significant exception to the prohibited tying for "a loan, discount, deposit, or trust service" (commonly referred to as the "traditional bank product exception"). For example, under the exception, a bank may condition the availability of a certain loan product on a customer also opening a deposit account at the bank.[41]

In addition, under subsection (1)(B), the statute provides a bank may not tie the referenced financial services to a requirement that the customer obtain some additional credit, property, or service from the bank holding company of the bank, or from another subsidiary of the bank's holding company.[42] Thus, a bank may not increase the interest paid on a deposit account on a requirement that the customer purchase homeowner's insurance from the bank's affiliate. Finally, the statute also affirmatively authorizes the Board of Governors of the Federal Reserve System ("Board") to grant exceptions to the statute's prohibitions.[43]

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[41] Further discussion of this exception appears subsequently in subsection B.3. of this paper.

[42] Section 106(b) also prohibits certain reciprocity and exclusive dealing arrangements not under discussion here. Section 106(e) provides a private remedy for individuals alleging a tying violation, including the right to seek treble damages (codified at 12 U.S.C. § 1975).

[43] *See* 12 U.S.C. § 1972(1) ("The Board may by regulation or order permit such exceptions to the foregoing prohibition as it considers will not be contrary to the purposes of this chapter."). As explained by Senator Bennett, this leaves to the Board "only the task of exempting further activities of the same sort which it may determine to be desirable in the best interest of sound banking practices." Vol. 116 Cong. Rec. 32125 (Sept. 16, 1970).

Hence, the legal framework applicable to tying arrangements subjects banks to possible claims under section 106(b) of the BHCA Amendments as well as under the general antitrust laws,[44] but not all tying is illegal. Under the general antitrust laws, a more stringent evidentiary showing of specific adverse effects on competition and sufficient economic power over the tying product, among other factors, may be required. Moreover, the plain language of section 106(b) provides an express exception from prohibited tying for so-called traditional bank products, grants broad exemptive authority to the Board, and does not cover ties initiated or sought by a customer.

Special issues arise if a bank conditions the availability or price of a product on the customer obtaining additional products from the bank or an affiliate, but gives the customer the freedom to choose whether to satisfy the bank's condition by purchasing either traditional bank products or other "non-traditional" products (a "mixed-product arrangement"). In such a "mixed-product" arrangement, the bank has conditioned the availability or price of the customer's desired product on a requirement that the customer purchase *some* additional product from the bank or an affiliate.

However, as discussed above, a bank is permitted to tie the availability or price of credit (or other products) to the purchase of one or more traditional bank products from the bank or an affiliate. Thus, section 106 would not prohibit a bank from conditioning the grant of a loan to a customer on a requirement that customer obtain one or more of the traditional bank products listed above from the bank or its affiliates. Allowing the bank to offer the customer the *option* of satisfying such a permissible condition through the purchase of traditional bank products or non-traditional products can increase the choices available to the customer *without* requiring the customer to purchase any non-traditional product from the bank or an affiliate.[45]

Of course, the bank must not be offering a choice it knows to be illusory; the bank must reasonably believe that the customer has the ability to satisfy the bank's condition *solely* through the purchase of *traditional bank products*. Such would not be the case, for example, if a bank, at the time of the offer, believes that the customer does not have the ability to satisfy the bank's condition solely through the purchase of traditional bank products. In such a case, the bank knows the customer does not have a meaningful choice of satisfying the bank's condition solely through the purchase of traditional bank products and, thus, the bank's mixed-product arrangement is effectively requiring the customer to purchase one or more non-traditional products in order to obtain the customer's desired product.[46] On the other hand, when the customer has a meaningful choice in determining whether to satisfy the bank's condition through

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[44] The legislative history and case law make clear that section 106(b) is not an exclusive remedy and that bank tying arrangements also may violate the federal antitrust laws.

[45] The Board previously has noted that the addition of non-traditional products to a menu of traditional bank products offered a customer may, in some circumstances, increase customer choice in a manner consistent with the purposes and intent of section 106. *See* 60 Fed. Reg. 20186, 20187-88 (Apr. 25, 1995). Indeed, this rationale formed the basis of the safe harbor for certain types of combined-balance discount programs adopted by the Board in 1995 as an exception to section 106. *Id.* This safe harbor is discussed further in subsection B.4.

[46] The Bank may, however, decline to provide a loan that is not sufficiently profitable without the purchase of another product or service.

the purchase of traditional bank products or non-traditional products, the bank's inclusion of non-traditional products on the menu of products the customer may chose gives the customer flexibility in determining how it may choose to satisfy a condition that the bank is permitted by law to impose.

Thus, the plain language of section 106 permits a bank to condition the availability or price of a product on the customer meeting the bank's profitability standards by obtaining additional products from the bank or an affiliate, if the customer can meet this condition through the choice of either traditional or "non-traditional" products. So long as the bank reasonably believes, based on information it knows when it makes the offer, that the customer has the ability to select traditional or non-traditional products to meet the bank's profitability standards, this type of practice is consistent with the statutory language. The bank's policies, procedures and documentation would be key to establishing that basis.

B. Section 106's Legislative History, Case Law, and Board Actions Support the Permissibility of Relationship Banking.

The legislative history, subsequent case law, and Board actions also provide substantial support for finding that relationship banking practices offering customers choice between traditional and non-traditional products and services does not raise the concerns underlying section 106, and is consistent with section 106's purposes. Indeed, these sources of authority strongly support Congressional intent to preserve banking practices based on consideration of a customer's entire relationship.

1. Section 106(b) Prohibits "Coercive" Not Voluntary Tie-Ins.

A primary concern of Congress was to prevent banks from using economic power to engage in *coercive* tie-ins. Coercive tie-ins, as described in the legislative history, involve a bank expressly or impliedly imposing a condition or requirement on the availability or price of the desired product, e.g., where customers are "forced" to accept a non-traditional product in order to obtain a traditional bank product, such as credit.[47] The statutory language stating "condition or requirement" came from the amendment offered on the Senate floor by Senator Bennett, and thereafter adopted. The earlier language, taken verbatim from section 3 of the Clayton Act, stated "condition, agreement, or understanding." This change in the language is instructive on the meaning of the provision. As Senator Bennett explained:

> The elimination of the words "condition or understanding," and the substitution of the word "requirement," are intended to eliminate possible inferences and implications of tie-ins…based on a bank's performance of two or more services for a particular customer, or the bank's providing a service to the customer and receiving a deposit or other service from the customer at the same time. The bill

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[47] *See* Conf. Rep. 91-1747, 91st Cong., 2nd Sess., *reprinted in* 1970 U.S.C.C.A.N. 5561, 5569 (Dec. 15, 1970) ("Conf. Rep.") ("Tie-ins occur where a customer is forced or induced to accept other products and services along with the product which he seeks.…Section 106 of the bill, which has come to be known as the anti-tie-in section, will largely prevent coercive tie-ins.").

> as amended would require that a condition or requirement imposed by the bank must be demonstrated in order to prove that a violation of the section has occurred.[48]

Coercive ties do not involve "choice" on the part of the customer, but are premised on the bank's power to control the situation. The anti-tying provisions were Congress's specific attempt to provide a safeguard against banks' "misuse of economic power" through coercion or other abusive tactics.[49]

A coercive tying arrangement is distinguishable from a so-called "voluntary tie" where the customer makes a decision to voluntarily move certain business to the bank or where the <u>customer</u> initiates a tie between two products. The legislative history provides repeated examples that section 106(b)'s tying prohibition was not intended to address voluntary ties, rather, "such voluntary tying, or sometimes called 'tying effect,' is the product of market structure, not misconduct."[50] As such, Congress left to the Board to deal with any dangers posed by voluntary tie-ins through the section 4(c)(8) bank holding company applications process and the consideration of competitive effects.[51] Thus, voluntary ties are not within the scope of section 106(b)'s prohibitions.[52]

Case law also supports section 106(b)'s intent to prohibit coercive ties. Following antitrust tying precedent, the Eleventh Circuit Court of Appeals maintains that one element of a section 106 tying claim is that the buyer was in fact "forced" to buy the tied product to get the tying product.[53] For example, in the *Integon* case the plaintiff sought a loan and the lender attempted to condition the loan on the purchase of certain other property. But, there was no actual legal obligation for purchase of the property at the time the loan closed; there was no reference to the

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[48] Vol. 116 Cong. Rec. 32125 (Sept. 16, 1970).

[49] S. Rep. 91-1084, 91st Cong., 2nd Sess., *reprinted in* 1970 U.S.C.C.A.N. 5519, 5535 (Aug. 10, 1970) ("S. Rep."); *see also id.* at 5561 (letter from Richard W. McLaren, Asst. Attorney General, Antitrust Div. (Jun. 26, 1970)) ("We believe the inclusion of this provision in the pending legislation would be a sound solution to the problems of tie-ins involving banks, particularly those which have developed as a result of bank control over credit.").

[50] *See, e.g.,* Conf. Rep. 91-1747 at 5569; Statement of Assistant Attorney General Richard L. McLaren, "One-Bank Holding Company Legislation of 1970," Hearings of the Senate Committee on Banking and Currency (May 18, 1970 et seq.) ("Senate Hearings").

[51] *See* Conf. Rep. 91-1747 at 5569.

[52] Other practices involving the linkage or "bundling" of certain products also may not come within the scope of the statute's prohibitions. For example, the language of the statute states "[a] bank shall not in any manner," but says nothing about a "customer" initiating a tie of certain products on a voluntary basis, such as a customer deciding to move its cash management business to a particular bank in an effort to receive more favorable credit arrangements.

[53] *See Integon,* 989 F.2d at 1150 (Plaintiff must prove that the lender "forced or coerced" the plaintiff into purchasing the "tied product"). *But see Dibidale v. American Bank and Trust Co.,* 916 F.2d 300 (5th Cir. 1990), *amended,* 941 F.2d 308 (1991) (no "coercion" requirement, only need sufficient evidence that defendants imposed a "condition or requirement" on plaintiff obtaining the desired product). In *Dibidale,* the court found "in the banking industry the power to coerce is inherent in the banking relationship itself." *Dibidale,* 916 F.2d at 306.

property in the loan documents; the plaintiff was sophisticated and represented by capable counsel; and deposition testimony indicated the plaintiff knew he could “walk away” from the transaction to purchase the property. These facts thus show the existence of a meaningful choice on the part of the customer to accept or reject the transaction offered. The Court concluded under these facts there was no “forced or coerced” tying and thus no violation of section 106.

Likewise, in another case, *Stefiuk*, the court found the plaintiff was not “forced” to take the tied product—opening an account—in order to obtain the tying product—*free* check cashing. A non-bank customer alleged an improper tie when the bank imposed a $1.00 check cashing fee, but the bank offered an alternative means to avoid the $1.00 fee, i.e. obtain a check cashing card or open an account. The emphasis here on options again illustrates the meaningful choice the plaintiff had of deciding whether to enter into the transaction. Thus, the court found there was not coercion. Courts also have upheld the legislative intent that ties voluntary in nature are not within the scope of the anti-tying statute.[54]

Various exemptions issued by the Board[55] under section 106 also recognize that choice by a customer in the selection of products or services is consistent with section 106’s legal framework and weighs against any suggestion of coercion by the bank.[56] In a 1995 rulemaking, for example, the Board addressed the effect of section 106 on combined-balance discounts, such as a bank offering price reductions or other improved terms on various services in return for a customer’s maintaining a specified combined minimum balance in specified products.[57] The Board explained 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

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[54] *See, e.g., Integon,* 989 F.2d at 1152 (court held it would not penalize defendants for the plaintiff's voluntary action—reasoning that the plaintiff voluntarily purchased the property because, under the facts alleged, he was under no condition or requirement to do so). *But see Dibidale,* 916 F.2d at 306 (questions whether tying arrangements are voluntary). However, a strong dissent in *Dibidale* objects to the majority’s reading that the bank suggesting that a customer use a particular service equates to its “forcing” him to do so. *See Dibidale,* 916 F.2d at 308. Other cases challenging Board orders provide further support on the nature and intent of voluntary ties. *See, e.g., Alabama Ass’n of Ins. Agents v. Board of Governors,* 533 F.2d 224 (5th Cir. 1977).

[55] Even though a practice may not be prohibited under section 106, the Board has recognized that granting an exemption, as opposed to an interpretation, provides certainty as to the permissibility of a particular practice. *See, e.g., Huntington Bancshares,* 1996 WL 275365 (F.R.B.) (May 23, 1996). Many Board issuances take this approach.

[56] *See, e.g., NationsBank Corporation, Letter from William W. Wiles to Richard Kim, Esq.* (Sept. 19, 1997) (“*Nationsbank letter*”) (Board granted exemption stating the practice “does not raise the concerns about coercion and anti-competitiveness that section 106 was intended to address”); *Fleet Financial Group,* 1994 WL 695705 (F.R.B.) (Oct. 19, 1994) (“requested exemption would simply permit Fleet to increase customer choice”); *Huntington Bancshares,* 1996 WL 275365 (F.R.B.) (May 23, 1996); (citing *Northern Pacific RR. Co. v. U.S.*, 356 U.S. 1, 6 (1958) (under antitrust law, concerns about tying arrangements are substantially reduced where the buyer is free to take either product by itself)).

[57] This rule followed the Board’s earlier order issued to Fleet Financial Group permitting Fleet’s subsidiary banks to offer a discount on the monthly service fee charged for its “Fleet One Account” to customers who maintained 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. *See Fleet Financial Group,* 1994 WL 695705 (F.R.B.) (Oct. 19, 1994).

the menu of traditional bank products that count toward the minimum balance."[58] The Board also noted it 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."[59]

Thus, a relationship banking practice that involves customers having the option of choosing from a full array of bank products and services, including traditional and non-traditional products, to meet the bank's profit hurdle and maintain their relationship with the bank is not the type of tying arrangement Congress sought to prohibit with section 106(b). This type of practice does not involve a coercive tie, or a "forced" conditional transaction. Rather, a customer has a range of choices that exceed those provided under section 106. Under section 106, banks may require customers who desire traditional banking products, such as loans, to meet relationship profitability standards through the use of other traditional banking products. With relationship banking, banks are expanding customer choice by permitting customers to select either traditional or non-traditional products to meet the bank's profitability standards. The legislative history of section 106, case law, and Board issuances provide ample support that this type of practice is consistent with the purposes underlying section 106 and not prohibited.

2. Congress Intended to Prevent Anti-Competitive Consequences Resulting From Improper Tying Arrangements.

Another significant concern during the legislative consideration of section 106 was the tying of certain banking services with other services in a way that might produce anti-competitive consequences. The House Conferees agreed to the Senate's anti-tying provision "particularly because of the necessity for protecting small independent businessmen from unfair and predatory business practices by banks, bank holding companies and subsidiaries thereof."[60] The Senate Committee Report indicated:

> The provision approved by the Committee is intended to provide specific statutory assurance that the use of the economic power of a bank will not lead to a

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[58] 60 Fed. Reg. 20186, 20187 (Apr. 25, 1995).

[59] 60 Fed. Reg. at 20188. The Board also has granted subsequent exemptions that extend customer choices further. *See, e.g., Nationsbank letter* (customer given the choice of two accounts offering the same package of discounts and other banking services but one conditioned on maintenance of a minimum balance in brokerage products and the other conditioned on a minimum balance in deposit products).

[60] Conf. Report 91-1747 at 5580. Throughout the hearing testimony are references to unfair practices that might harm or potentially harm small independent businesses, such as insurance agencies, and individual consumers. *See, e.g.,* "Bank Holding Company Act Amendments," Hearings Before the House Committee on Banking and Currency (Apr. 15, 1969 et seq.) ("House Hearings"); Testimony of William Martin, Jr., Chairman, Board of Governors of the Federal Reserve System, House Hearings, at 200 (preserve traditional test of anti-competitive effects to safeguard against tie-in arrangements where an opportunity arises to force sales of one service upon customers who wish to buy another). A substantial amount of hearing testimony came from insurance industry representatives. *See, e.g.,* Prepared Statement of Charles L. Rue, Jr. National Ass'n of Mutual Insurance Agents, House Hearings, at 788 (prevent unfair competitive advantages); Statement of Morton V.V. White, National Ass'n of Insurance Agents, Inc., Senate Hearings, at 461-75 (unfair use of bank pressure to sell insurance).

> lessening of competition or unfair competitive practices. Thus, the provision is intended to affirm in statutory language the principles of fair competition. The Committee does not intend, however, that this provision interfere with the conduct of appropriate traditional banking practices….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.[61]

The legislative history emphasized the intent was to safeguard against future improper, anti-competitive tying practices.[62] During the House hearings, Assistant Attorney General, Richard McLaren, described the context of the competitive problem in permitting banks to enter related businesses and the need for the tying safeguard. He remarked:

> Particularly where money is tight, as it is now, there is the possibility that a bank might engage in tie-ins…Owing to these potential anti-competitive effects,…safeguards [must be] provided…The bill contains one other safeguard that I have not mentioned. That is the provision that would outlaw express tie-ins between credit and other services which might be offered by the holding company or its affiliates.[63]

Senator Brooke indicated in his supplementary views to the Senate Committee Report that bank tying arrangements "are made unlawful by this section without any showing of <u>specific</u> <u>adverse</u> <u>effects</u> <u>on</u> <u>competition</u> or other restraints of trade."[64] Clearly significant legislative concern focused on improper tying practices by banks, such as express tie-ins involving credit, that might endanger fair competition, particularly for small businesses and consumers.

Nonetheless, the legislative history also recognizes that not all bank tying practices hinder competition, and that Congress did not intend to prohibit all tying practices. In describing his Senate floor amendment specifically exempting certain products from the tie-in provision,

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[61] S. Rep. 91-1084 at 5535.

[62] *See, e.g.,* S. Rep. 91-1084 at 5522 ("It is clearly understood that the legislation is to prevent possible future problems rather than to solve existing ones.").

[63] House Hearings, at 91-92 (Apr. 17, 1969).

[64] S. Rep. 91-1084 at 5558 (emphasis added). Senator Brooke's full comment from the Committee Report's supplementary views provided: "Because of their inherent anti-competitive effects, which may operate to the detriment of bank customers as well as banking and nonbanking competitors, tying arrangements involving a bank are made unlawful by this section without any showing of specific adverse effects on competition or other restraints of trade and without any showing of some degree of bank dominance or control over the tying product or service. Moreover, as individual tying arrangements may involve only relatively small amounts, the prohibitions of this section are applicable regardless of the amount of commerce involved." *Id.* Later, shortly before the vote on the final bill, Senator Brooke explained: "The anti-tying provision addresses Congressional concerns over the tying of certain banking services with other banking services, as well as the coupling of banking services with non-banking services in such a way as to produce anti-competitive consequences." Vol. 116 Cong. Rec. 42432 (Dec. 18, 1970).

Senator Bennett explained: [t]his amendment, which is based on the committee report, is designed to eliminate from the restrictions of section [106] traditional banking practices which do not generally, if ever, have any anti-competitive effects and which in many cases are vital to the conduct of sound banking.[65]

Thus, overall, the intent of Congress reflected in the legislative history is mixed. Although a specific showing of anti-competitive effect seemingly was not required by the tying provision's language, the clear legislative intent centered on prohibiting "improper tie-ins" that would decrease competition or result in unfair business practices. Thus, Congress seemed most concerned with tie-ins that would effectively coerce a party to take a product it did not want.

Court decisions also reflect the Congressional emphasis on "anti-competitive" tying arrangements, although somewhat inconsistently. Some courts analyze section 106 expressly to require a showing that the alleged practice was anti-competitive.[66] For example, the Seventh Circuit has recognized the anti-tying provision "proscribes certain conditional transactions where their effect would be to increase the economic power of banks and to lessen competition."[67] The court further elaborated, however, even under the statute's "relaxed" per se approach to bank tie-ins, a plaintiff seeking relief must complain of a practice that is anti-competitive.[68]

Other courts, however, describe a section 106 unlawful tying claim as dispensing with any actual requirement demonstrating the bank's market power or the "anti-competitive effect" of the alleged arrangement, which were the cornerstones of establishing tying claims under the general antitrust statutes.[69] In this way, the courts differ in their views on requirements relating to anti-competitiveness. Nevertheless, the circuits all generally recognize that the Congressional intent

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[65] Vol. 116 Cong. Rec. 32125 (Sept. 16, 1970).

[66] *See e.g., Davis,* 868 F.2d at 208 (7th Circuit); *Rayman,* 75 F.3d at 356 (8th Circuit); *Parsons Steel, Inc.,* 679 F.2d at 245 (11th Circuit).

[67] *Davis ,*868 F.2d at 207 (purpose and effect of section 106 is "to apply the general principles of the Sherman Act prohibiting anti-competitive tying arrangements specifically to the field of commercial banks, without requiring plaintiffs to establish the economic power of a bank and specific anti-competitive effects"); *see also Rayman,* 75 F.3d at 356 (must show challenged banking practice was unusual in the banking industry; resulted in an anti-competitive tying arrangement, and benefited the bank); *Parsons Steel, Inc.,* 79 F.2d at 245 ("unless the 'unusual' banking practice is shown to be an anti-competitive tying arrangement which benefits the bank, it does not fall within the scope of [section 106's] prohibitions").

[68] *Davis,* 868 F.2d at 208. Likewise, the Tenth Circuit finds that "plaintiffs must show that the practice complained of is anti-competitive, that the practice results in unfair competition or could lesson competition." *Palermo v. First Nat'l Bank and Trust Co.,* 894 F.2d 363, 368 (10th Cir. 1990). The court rejected plaintiff's contention that no anti-competitive practice need be shown, but clarified that plaintiffs are "not required to prove actual anti-competitive effects of the challenged practice, such as a bank's dominance or control over the tying product market or that a substantial volume of commerce is affected." *Id.*

[69] *See Integon,* 989 F.2d at 1150 (section 106 tying claim has two elements: (1) two separate products, a tying or desirable product, and a tied or undesirable product, and (2) the buyer was in fact forced to buy the tied product to get the tying product); *see also S&N,* 97 F.3d at 346 ("while our test speaks in terms of an 'anti-competitive' tying, the modifier either drops out or is presumed to exist"); *Dibidale,* 916 F2d. at 305 (section 1972 claim need not demonstrate the tying bank's market power or the anti-competitive effect of the alleged arrangement).

was to prohibit certain types of tying practices that would “lead to a lessening of competition or unfair competitive practices.”[70]

Further, Congress addressed its concerns related to the harmful effects of anti-competitive tying on individuals by including in the legislation a private remedy for individuals to seek relief, including the recovery of treble damages. Subsequently codified as 12 U.S.C. § 1975, Congress intended “these private rights of action to be a valuable supplement to the enforcement efforts of the United States Attorneys.”[71]

Actions by the Board also emphasize the competitiveness concerns underlying section 106. However, the Board has found that arrangements that do not raise the anti-competitive concerns section 106 intended to address and that provide benefits to customers are not prohibited by the statute, and thus are permissible.[72] The Board has stated the presence of other competitors in the product markets also lessons concerns that a bank offering certain packaged products and discounts, for example, would impair competition in other product markets.[73]

The anti-competitive consequences that concerned Congress simply are not present in today’s highly competitive commercial credit markets. As previously described in detail under Part III, “Economic and Market Analysis of Relationship Banking,” banks actively compete on a national basis with bank and nonbank entities for lending and other types of financial business with customers. Nonbank competitors themselves may even offer bank-like products in today’s markets. Moreover, the customers involved are not small businesses and individuals, arguably the key concern of Congress, but rather large, sophisticated, financially diverse companies. The relationship banking practices offering choices of multiple products to maintain these customer relationships further promote and maintain the competition in today’s markets. Such practices also provide customers potentially better pricing and greater conveniences and efficiencies in their financial dealings. These effects are in stark contrast to the Congressional concerns in 1970 of decreasing competition or competing unfairly. As such, relationship banking practices are consistent with the legislative intent underlying section 106 and are not anti-competitive.

3. Congress Intended to Preserve Traditional Banking Practices and the Ability of Banks and Customers to Negotiate Their Relationship.

Congress did not intend to interfere with appropriate “legitimate,” “traditional,” or “normal” banking practices, or disturb banking practices based on sound economic analysis. Moreover, Congress intended to preserve the ability of banks and customers to negotiate on the basis of the entire customer relationship and recognized the value of customers taking full advantage of the economies and efficiencies of full-service banking.

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[70] *Dibidale,* 916 F2d. at 305; *see also Davis,* 868 F.2d at 209; *S&N,* 97 F.3d at 346.

[71] S. Rep. 91-1084 at 5536.

[72] *See, e.g., NationsBank Corporation, Letter from William W. Wiles to Richard Kim, Esq.* (Sept. 19, 1997); *Fleet Financial Group,* 1994 WL 695705 (F.R.B.) (Oct. 19, 1994).

[73] *See Fleet Financial Group,* 1994 WL 695705 (F.R.B.) (Oct. 19, 1994).

This intent of section 106 is clear from the sequence of events culminating in passage of the bill, as reflected in the Conference Report, the Senate Committee Report, and other legislative history. Both before and after adoption of the specific amendment excepting traditional bank products from the scope of the prohibition, Congress emphasized preserving the ability of negotiation based on the total customer relationship with the bank. The Senate Committee Report expressly stated that the Committee did not intend the anti-tying provision to "interfere with the conduct of appropriate traditional banking practices."[74] The Report explained:

> This will enable the customer to continue to negotiate with the bank on the basis of his entire relationship with the bank. For example, where the customer uses multiple banking services such as deposit, loan, fiduciary, and commercial accounts or facilities, the parties may be free to fix or vary the consideration for any services upon the existence or extent of utilization of such banking services. (emphasis added).[75]

Senator Brooke elaborated that "it is not the intention of this Committee that Section [106] invalidate sound banking practices. To achieve this goal, adequate discretion is vested in the Federal Reserve Board to provide exceptions where such are founded on sound economic analysis."[76]

Despite this clearly stated intent, Senator Bennett and others expressed strong concern that the Committee's bill might jeopardize "normal" and "legitimate" banking practices and advocated the need for an amendment to the language of the provision.[77] They explained an amendment must show that "the purpose of this section is to prohibit only those tying arrangements whose effect may be to lessen competition or tend to create a monopoly in any type of credit or property transactions or in any type of services" engaged in by a bank.[78] In introducing the amendment on the Senate floor, Senator Bennett described the intent as follows:

> [T]his amendment would except a loan, discount, deposit, or trust service. This will, among other things, enable the customer to continue to negotiate his costs

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[74] S. Rep. 91-1084 at 5535.

[75] *Id.*

[76] *Id.* at 5558.

[77] *See* S. Rep. 91-1084 at 5546-47 (supplementary views of Senators Bennett, Tower, Percy and Packwood) ("The bill language prohibits all tying arrangements involving any bank without any reference to possible adverse effects on competition or other restraints of trade and without any reference to bank dominance or any reference to exceptions for normal banking practices."). The Senators feared the language of the bill would "make certain bank practices, which exist for completely legitimate reasons and which increase competition among banks, per se violations of antitrust law whether there is an anti-competitive effect or not." *Id.*

[78] S. Rep. 91-1084 at 5547. Another active participant in the considerations, Senator Brooke, recognized "it is not the intention of this Committee that [the anti-tying provision] invalidate sound banking practices." S. Rep. 91-1084 at 5558.

> <u>and fees</u> with the bank <u>on the basis of his entire relationship with the bank</u>, as the committee report points out on page 17. Clearly, neither a bank nor its customer should be attacked under section [106] for <u>taking advantage of the economies and efficiencies of full-service banking</u>.[79]

Further evidence showing the clear Congressional intent to preserve legitimate banking practices is the grant of exemptive authority to the Board prior to the adoption of the specific exception for traditional bank products. As expressed by Assistant Attorney General McLaren, by authorizing the Board to permit exceptions, "[t]he proposed section apparently seeks to lessen the danger of overly broad interpretations of the prohibitory language."[80] Senator Brooke added, [t]his grant of discretionary authority to the [Board] would certainly dispel any fear that legitimate banking practices would be disrupted."[81] Thus, the final anti-tie-in provision passed by Congress contains both a specific statutory exception for traditional bank products and a grant of exemptive authority to the Board.

Case law also strongly supports this Congressional intent not to interfere with traditional banking practices. As explained by the Eleventh Circuit, "[i]n regulating potential misuse of such economic power, however, Congress was concerned that federal regulation not be too expansive…Congress did not intend to 'interfere with the conduct of appropriate traditional banking practices,' and did not intend to prohibit attempts by banks to protect their investments where no anti-competitive practices were involved."[82]

In addition, in the years since 1970, the Board has taken numerous actions under the tying provision's grant of exemptive authority. These actions, typically in the form of a regulation or order, provide clarification on permissible tying practices, allow banks greater flexibility for legitimate banking activities, and recognize changes in the banking industry and competitive markets. The Board's actions occur in instances where it determines that an exception will not be contrary to the purposes of the tying statute, the practice benefits the banking organization and its customers, and no anti-competitive effects are present.

In discussing the purposes of section 106, the Board has reaffirmed Congress's intent that "the statutory traditional bank product exception was intended to preserve a customer's ability to

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[79] Vol. 116 Cong. Rec. 32125 (Sept. 16, 1970) (emphasis added); *see also* Letter from Arthur F. Burns, Chairman of the Board of Governors of the Federal Reserve System (Sept. 14, 1970) (recommends adoption of the amendment clarifying customer use of multiple banking services); Letter from Samuel R. Pierce, Jr., General Counsel, Dept. of the Treasury (Sept. 11, 1970) (urges revision of the provision's language "to make clear that it does not apply to traditional and unobjectionable banking practices").

[80] S. Rep. 91-1084 at 5560 (Letter from Richard W. McLaren, Assistant Attorney General (Jun. 26, 1970)).

[81] *Id.* at 5558 (views of Senator Brooke).

[82] *Parsons Steel, Inc.,* 679 F.2d at 245; *see also Palermo,* 894 F.2d at 369 (tying statute not intended to prevent bank from taking steps to insure adequate security for its loans; bank did no more than evaluate its entire existing relationship with customer); *Davis,* 868 F.2d at 207 (nor was it intended to prohibit banks from protecting their investments); *Stefiuk*, 61 F. Supp. at 1299 (plain language exempts condition that customer obtain deposit service, i.e., open an account).

negotiate the price of multiple banking services with the bank on the basis of the customer's entire relationship with the bank."[83] The Board has noted the value of providing customers greater choices and lower costs for products offered in competitive markets.[84] Further, the Board recognizes its legislative authorization to permit exceptions on the basis of sound economic analysis.[85]

Cognizant of changes in the financial services industry and the evolving nature of banking, in 1997, the Board adopted significant amendments to its tying regulation.[86] The Board explained the purpose of the changes:

> The amendments. . . create exceptions from the statutory restriction on bank tying arrangements to allow banks greater flexibility to package products with their affiliates; and establish a safe harbor from the tying restrictions for certain foreign transactions. These amendments are designed to enhance competition in banking and nonbanking products and allow banks and their affiliates to provide more efficient and lower-cost service to customers.[87]

Specifically with respect to "packaging" or "bundling" products, and relationship banking practices, the Board indicated:

> [I]n the past few years, [the Board] has used its exemptive authority to allow banking organizations to package their products when doing so would benefit the organization and its customers without anti-competitive effects. For example, the Board has allowed arrangements that included discounts on brokerage services and other products based on a customer's relationship with the bank or bank holding company. The final rule would build on this recent history by permitting broader categories of packaging arrangements that also do not raise the concerns that section 106 was intended to address.[88]

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[83] *Huntington Bancshares,* 1996 WL 275365 (F.R.B.) (May 23, 1996).

[84] *Fleet Financial Group,* 1994 WL 695705 (F.R.B.) (Oct. 19, 1994).

[85] *See, e.g., Huntington Bancshares,* 1996 WL 275365 (F.R.B.) (May 23, 1996); *Fleet Financial Group,* 1994 WL 695705 (F.R.B.) (Oct. 19, 1994).

[86] Earlier, the Board promulgated a regulation providing regulatory exceptions to the tying prohibitions, such as extending the traditional bank product exception to bank affiliates, and providing a safe harbor exception for combined-balance discounts. Under the regulatory exception, for example, a bank may offer a discount on a loan on the condition that a customer maintain a deposit account at an affiliated bank. *See* 12 C.F.R. § 225.7. Subsequent opinions also broaden and clarify the scope of exceptions. *See, e.g.,* Letter from J. Virgil Mattingly, General Counsel (May 16, 2001) ("any financial products offered by a bank or its affiliates, including insurance products, may properly be included among the eligible products in that bank's combined balance discount program.").

[87] 62 Fed. Reg. 9290, 9312 (Feb. 28, 1997).

[88] 62 Fed. Reg. at 9313.

The relationship banking practices under discussion fall within the intent of Congress not to disturb legitimate banking practices and subsequent interpretation by the Board with respect to appropriate practices consistent with the legal framework. Congress clearly recognized and intended to preserve a bank's ability to provide multiple products to a single customer, the value of negotiating on the basis of the entire customer relationship, and the ability of customers to take advantage of the economies and efficiencies of an entire array of products and services offered by the bank. The ability of a bank to evaluate a customer's profitability to the business entity and make appropriate business decisions relative to the circumstances seems beyond question, but is further amply supported by the legislative history.

Likewise, the Board's actions under section 106 permit bank practices based on sound economic analysis that involve negotiation on the basis of the entire customer relationship, provide additional flexibility for packaging products, and promote competition in current markets. Further, Board actions allow banks to include traditional and non-traditional products under various programs as long as customers have choice. Accordingly, banks offering customers the choice of an array of multiple products, including those termed traditional or non-traditional, and negotiating on the basis of the overall customer relationship in an effort to permit the customer to meet profitability goals, are engaging in practices preserved by the framework of section 106.

4. Congress Intended Section 106(b) to Permit Banks to Evolve.

During the lengthy legislative consideration of the BHCA Amendments, including the anti-tying provisions, Congress also recognized that banking was not static. Rather, the view prevailed that "modern banking goes far beyond the handling of demand deposits. It involves a variety of specialized services and it is a dynamic industry which has changed and is changing substantially, almost from day to day."[89] The Senate Committee Report captures particularly well this Congressional intent to support the evolving nature of banking activities:

> Banking is not a static form of activity. Modern bankers are offering a variety of specialized services which would have been entirely unknown to their predecessors of a few generations ago. . . Innovation in financial fields should be encouraged. It seems particularly desirable to permit banks to enter other financial markets when competition is weak, or where bank can be expected to offer real efficiencies.[90]

[89] Statement of Hon. Richard W. McLaren, Assistant Attorney General for Antitrust, House Hearings, Bank Holding Company Act Amendments 91 (Apr. 17, 1969) ("we must steer a course which avoids anti-competitive activities and undue economic concentration, on the one hand, and an inflexible constraint on the logical expansion of bank activities, on the other hand").

[90] S. Rep. 91-1084 at 5532; *see also* Senate Hearings, Testimony of Federal Reserve Board Chairman Arthur Burns 149 (May 14, 1970) (preserve "ample opportunity for businesses to grow, for banks to grow, for banks to innovate, and yet [maintain] a certain line, a fairly rough and wavy line…between banking and industry"); H. Rep. 91-387, 91st Cong., 1st Sess. 37 (Jul. 23, 1969) (Add'l Views of Congresswoman Heckler) ("Banking in my judgment should not be confined to being a static activity in our dynamic society.").

Subsequent Board actions also provide recognition of banks' changing and evolving nature. For example, in issuing the final rule on combined-balance discounts, the Board noted "commenters commended the Board for recognizing that the financial services industry is evolving as banks provide customers a broader range of financial services."[91]

The Congressional recognition of the evolving nature of banking evinces Congress's intent that appropriate banking practices are not frozen in time and further supports the conclusion that relationship banking can be consistent with the legal framework. Similarly, this recognition and intent to permit evolution supports a flexible interpretation of the scope of traditional bank products encompassed by the statutory exemption. Modern versions of those "traditional" bank products also should be included in the exemption.

As banks offer customers a broader range of products, customers may meet banks' internal profitability standards through the use of either traditional or newer versions of those products that banks offer today. Updated forms of relationship banking enable banks to function effectively in today's competitive markets and to offer customers meaningful choices of products and services relevant to the bank's business interests in terms of profitability. Thus, the practices provide benefits both to customers and banks, in a competitive manner, and are not inconsistent with the purpose and framework of the statute.

5. Conclusion on the Legal Framework of Section 106(b).

Overall, consideration of the legislative history, case law, and Board actions on section 106(b) strongly support a conclusion that the relationship banking practices as described above are consistent with the legal standards and spirit of section 106 and do not involve the type of practices Congress intended to prohibit. As discussed, these practices do not "condition or require" the purchase of a particular product, involve coercion or force, and do not narrow the choices for customers. Instead, these practices promote competition on a national scope, provide customers greater choices and efficiencies, and reflect changes necessary to compete in the dynamic and ever-changing banking and financial services industry.

C. Safety and Soundness Considerations.

Other considerations also are relevant to the tying discussion and transactions with affiliates. National banks may not charge below market rates on credit or other products to benefit affiliates. These practices are unsafe and unsound and contrary to sections 23A and 23B of the Federal Reserve Act.[92] In general, section 23A places various restrictions on a bank's financial transactions with its affiliates and specifies certain limits and collateral requirements related to

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[91] 60 Fed. Reg. at 20187 (Apr. 25, 1995); *see also* 62 Fed. Reg. at 9313 (final rule builds on recent history of Board permitting broader categories of packaging arrangements that also do not raise the concerns that section 106 was intended to address).

[92] 12 U.S.C. § 371c and § 371c-1.

borrowings and other covered transactions. Section 23B provides further restrictions on transactions with affiliates.

In particular, section 23B prohibits banks from making an extension of credit to a borrower at below market terms where an affiliate, including an underwriting affiliate, is a "participant" in the transaction or where the proceeds of such extension of credit are used for the benefit of an affiliate. Such extensions of credit must be on terms and conditions that are substantially the same, or at least as favorable to the bank, as those prevailing at the time for comparable transactions not involving affiliates, or, in the absence of comparable transactions, on terms and conditions, including credit standards, that in good faith would be offered, or would apply.

These standards would apply in the context of the relationship banking practices being discussed. Relationship banking in general does not necessarily implicate section 23A and 23B, although certain specific situations could be problematic. For example, in offering an array of products and services for a customer to choose from, a bank that lowers pricing on a loan in order to obtain underwriting business for an affiliate could raise issues under section 23B. To negate problems, best practice guidelines established at the banking organization could require that the loan underwriting documentation contain evidence that the applicable transaction was underwritten, structured, and priced on an arm's length basis. The documentation could include, for example, narratives on the loan negotiations, information on comparable market rates derived from authoritative sources, and computations of loan pricing. Thus, while a particular transaction could raise certain issues, nothing inherent in the relationship banking practices suggests terms and conditions inconsistent with safe and sound banking practices, and the requirements of sections 23A and B.

V. Conclusion.

Recent developments and widespread relationship banking practices in today's commercial credit markets have heightened concerns relating to possible impermissible tying by banks. Under federal anti-tying law, banks may not require or force a customer to obtain one product as a condition to the bank providing another product, with various exceptions. Relationship banking practices involving an evaluation of whether a customer's total relationship with the institution meets internally-established profitability standards have become commonplace, although, in fact, relationship business arrangements are nothing new to banks or corporate entities generally. To enhance revenues and meet profitability benchmarks, a bank may offer customers the choice of an array of additional products and services, including traditional bank products, such as loan and deposit products, and also non-traditional products, such as investment banking services. If standards are not met, a bank may make a necessary business decision to exit an unprofitable customer relationship.

There is virtually no empirical evidence directly focusing on the tying of lending and underwriting activities by national banks. The indirect evidence available is consistent with permissible packaging of products by diversified banks, and product linkage <u>at the behest of customers</u>. Nor do banks appear to possess market power in lending to larger commercial customers that are the most likely targets for tying. Pricing power in this market is a necessary condition for effective tying by banks. Moreover, banks have made only modest inroads in

investment banking to date, which appears to have enhanced competition in this market. While banks have gained investment banking market share, specialized investment banks continue to dominate.

Applying the anti-tying legal framework to relationship banking strongly supports a conclusion that today's practices can be consistent with the plain language of section 106 and the purposes underlying enactment of the statute. A review of relevant considerations in the legislative history, subsequent case law, and Board actions collectively show the permissibility of the relationship banking practices under discussion. Section 106(b), as enacted, and as codified at 12 U.S.C. § 1972, prohibits coercive tying arrangements where a bank forces a customer to take an unwanted product. The law does not apply to voluntary tie-ins nor prohibit by its terms tying arrangements based on a customer's meaningful choice from an array of products and services offered in an effort to meet a bank's profitability standards. The legislative history also evinces Congress' understanding that banking is dynamic and banking practices evolve. Congress did not intend section 106(b) to be frozen in time, just as Congress recognized banking is not static.

The economic and legal analysis presented in this paper provides background for the appropriate federal banking agencies concerning the scope of section 106. Notably, as discussed, the anti-tying statute specifically provides the Board the authority to issue orders or regulations that permit exceptions to the statutory prohibitions. Proposed interpretations by the Board addressing various relationship banking practices raising issues under the anti-tying provisions will be both useful and entirely consistent with the legal framework discussed herein.