

May 28, 2003

## Memorandum

### **Legality Of Relationship Banking Under Bank Antitying Restrictions**

Like other businesses, banking organizations routinely take into account the profitability of a customer's overall relationship with the bank in deciding whether to do business, or continue to do business, with that customer. That is the guiding principle behind "relationship banking," a term that is used to describe a variety of different interactions between banks and their customers. As discussed below, banking organizations have engaged in relationship banking for many years as a safe and sound banking practice that produces significant customer benefits.

Recently, however, some critics have claimed that relationship banking may involve illegal "tying." These claims do not involve any suggestion that banks have violated the antitying restrictions of the antitrust laws, which apply fully to banks in the same manner as they do to other companies. Instead, critics point to section 106 of the Bank Holding Company Act Amendments of 1970, which imposes additional antitying restrictions that apply uniquely to banks. Because these restrictions apply to banks in addition to the antitying restrictions of the antitrust laws, section 106 has been carefully crafted and interpreted to apply only to very specific kinds of activities of banking organizations.

This memorandum analyzes the application of section 106 to a variety of particular practices or scenarios associated with relationship banking. Such scenarios include, among others, circumstances in which customers request or demand that a bank provide multiple services; a bank conditions one bank product on customers obtaining a separate "traditional" bank product; or a bank conditions a bank product on customers obtaining either traditional or non-traditional bank products, at the customer's choice.

Based on our analysis of the statutory text, legislative history, regulatory guidance, and case law, we conclude that all but one of the seven relationship banking scenarios we have examined are permitted under section 106.<sup>1</sup> As explained below, the broad range of permissible relationship banking practices is consistent with (1) the limited scope of section 106; (2) the fact that banks and their affiliates remain fully subject to the antitying restrictions of the antitrust laws; and (3) the recognized benefits to banks and their customers of "bundled" products and services.

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<sup>1</sup> There can, of course, be other relationship banking scenarios or variations on these scenarios that might or might not be permitted under section 106, depending on their facts.

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**A. Overview of Relationship Banking**

Relationship banking has been a common business practice for decades. Indeed, the legislative history of the bank tying prohibition, enacted in 1970, includes a number of express and approving references to relationship banking. For instance, the Senate Committee Report prominently recognized that even in the wake of the bank tying prohibition, a customer should be able “to continue to negotiate with the bank *on the basis of his entire relationship with the bank,*” and “where the customer uses multiple banking services . . . 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.*”<sup>2</sup> In addition, key supporters of section 106 affirmed the efficiency of “full-service banking” and “one-stop shopping, whether it be for groceries or financial services,” and spoke approvingly of the fact that, despite section 106, pricing could still be based on a customer’s “entire relationship with a bank.”<sup>3</sup>

Congress’s desire to preserve relationship banking was not surprising, as the practice can provide numerous benefits to banks and their customers. For example, the integrated delivery of financial services can save the customer time and transaction costs. Business customers with a variety of financial needs can benefit significantly from the streamlined delivery of credit, cash management, foreign exchange, derivatives, pension, and other services from the same institution. The analysis of credit risk involved in a syndicated bank loan and a credit derivative transaction can be strikingly similar, and a single firm may be able to provide both products more efficiently than could two entirely distinct organizations. Customers also can benefit by negotiating more attractive pricing across the board on the basis of the volume of products that they are purchasing. In short, in competitive markets where a participant does not have the kind of “market power” that generates antitrust concerns, the bundling of products is widely recognized as a practice that can produce substantial customer benefits.

In addition, from a safety and soundness perspective, relationship banking can help ensure that banks are able to generate a sufficient return on capital to support the extension of credit. As the Federal Reserve Board and the Office of the Comptroller of the Currency (“OCC”) have recognized, a bank’s return from commercial lending alone is often not sufficient to clear its internal “hurdle rate,” given the amount of capital that must be committed to support a large line of credit, and banks have had to find other ways to make relationships sufficiently profitable to support such lending:

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<sup>2</sup> S. REP. NO. 91-1084, at 17 (Aug. 10, 1970) (emphasis added).

<sup>3</sup> See Letter from Deputy Attorney General Richard G. Kleindienst to the Honorable Wright Patman (Nov. 17, 1970), at Cong. Rec. H11793 (Dec. 16, 1970) (desire to preserve “full service banking”); Cong. Rec. S15713 (Sept. 16, 1970) (statement of Sen. Bennett) (acknowledging value of “one-stop shopping, whether it be for groceries or financial services”); CONF. REP. NO. 91-1747, at 17 (Dec. 15, 1970) (bank tying prohibition does not interfere with customer’s ability “to continue to negotiate on the basis of his entire relationship with the bank”).

One critical component [of emerging capital allocation methodologies] is the corporate return on equity required by shareholders, which can be very different for companies even in the same industry. We understand that in some cases individual transactions conducted by a business at market prices may be insufficient to meet these internal hurdle rates. . . . Accordingly, many banking institutions and investment banks are increasingly taking a relationship approach in meeting the needs of their customers given the market prices they can charge for their products and services.<sup>4</sup>

If a bank's extension of credit alone does not clear its hurdle rate, then it does not make economic sense for the bank to enter into the transaction on a stand-alone basis. But it would be economically unproductive for the bank simply to refuse to provide the loan without exploring other ways of making the customer relationship sufficiently profitable. Instead, banking organizations understandably seek to expand customer relationships in ways that will allow them to provide the desired credit while obtaining a sufficient risk-adjusted return on capital. When banking organizations do so, customers benefit by having the option of continuing the relationship, which would be unavailable if the bank simply refused to make the loan. As described below, there are many permissible approaches for banking organizations to expand their customer relationships, including cross-selling and cross-marketing, engaging in certain forms of discount pricing based on the volume of services purchased, and legal tying involving traditional bank products in accordance with statutory and regulatory exceptions.

Many of the recent questions about anticompetitive tying practices have arisen in the context of large, syndicated commercial loans. Borrowers in this market, however, are large multinational corporations with the resources and sophistication to negotiate on equal terms with banking organizations. In addition, the syndicated commercial loan market is the largest capital market in the world, with over \$1 trillion of annual volume and hundreds of financial institution participants. In this large and highly liquid market comprised of sophisticated borrowers and lenders, there is no credible evidence that banks have the kind of "market power" that can lead to abusive tying practices.<sup>5</sup>

Moreover, the members of a loan syndicate frequently include lenders and investors that have no independent relationship with the loan customer. Almost by definition, such independent participation in a syndicate makes it very difficult for a lead bank to misprice a loan as a "loss leader" to secure additional business that would benefit only the lead bank. This conclusion – that the pricing of syndicated loans does *not* involve unlawful tying – is supported by the dearth of confirmed violations of section 106 despite (1) a targeted 1997 study by the

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<sup>4</sup> Letter from Federal Reserve Board Chairman Alan Greenspan & Comptroller John D. Hawke, Jr. to Rep. John D. Dingell (Oct. 16, 2002), App. at 4.

<sup>5</sup> See D. Mullineaux, "Tying and Subsidized Loans: A Doubtful Problem" (May 2003) at 2-4 ("It is clear, therefore, that one of the assumed conditions for a tying strategy to yield net benefits (market power in the tying product) does not pertain in the large commercial loan market.").

General Accounting Office (“GAO”);<sup>6</sup> (2) ongoing supervision by the Federal Reserve Board and other federal banking regulators; and (3) the incentive for aggrieved parties to bring civil actions for treble damages for tying violations, which are expressly authorized by section 106 for tying violations.<sup>7</sup>

## B. Enactment of the Bank Tying Prohibition

Section 106(b) of the Bank Holding Company Act Amendments of 1970 (the “1970 Amendments”) makes it illegal, with certain exceptions, for a bank to extend credit or furnish any other service, or vary the price of such service (the “tying product”), on the “condition or requirement” that customers obtain some additional product or service from the bank or its affiliate (the “tied product”).<sup>8</sup> A key exception is that banks may condition the price or availability of a service on customers obtaining a “traditional” bank product, *i.e.*, a “loan, discount, deposit, or trust service.”<sup>9</sup>

Before 1970, the Bank Holding Company Act of 1956 (“BHCA”)<sup>10</sup> applied only to companies that controlled two or more banks. The primary purpose of the 1970 Amendments was to prevent bank holding companies that owned only one bank from avoiding regulation under the BHCA.<sup>11</sup> Specifically, in the 1960s, many nonbank corporations had acquired a single bank, allowing them to engage freely in both banking and commercial activities.<sup>12</sup> Concerned with preserving a separation between banking and commerce, Congress closed the “one-bank loophole,” subjecting *all* bank holding companies to restrictions on their permissible activities as set forth in section 4(c) of the BHCA.<sup>13</sup>

At the same time, the BHCA was amended to permit some expansion in the range of nonbanking activities in which all bank holding companies could engage. This prompted concerns in some quarters that, because of banks’ role as credit providers, bank holding companies might be able to gain an unfair advantage in these other permissible nonbanking

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<sup>6</sup> See General Accounting Office, Bank Oversight: Few Cases of Tying Have Been Detected, GAO/GGD-97-58 (May 1997) (based on an independent study of litigation results as well as GAO’s own research, there were only 4 reported cases since 1972 in which banks were found to have violated section 106).

<sup>7</sup> See 12 U.S.C. § 1975.

<sup>8</sup> See 12 U.S.C. § 1972(1)(A). Section 106 also prohibits reciprocity and exclusive dealing arrangements, which are not at issue here.

<sup>9</sup> *Id.*

<sup>10</sup> Pub. L. No. 511, 70 Stat. 133 (*codified as amended at* 12 U.S.C. §§ 1841 et seq.).

<sup>11</sup> See CONF. REP. NO. 91-1747, at 12-13 (Dec. 15, 1970).

<sup>12</sup> See *id.*

<sup>13</sup> At the time of the 1970 Amendments, bank holding companies were restricted to activities that were “closely related to banking.” While the Gramm-Leach-Bliley Act, enacted in 1999, expanded those permissible activities to include essentially any *financial* activity, bank holding companies remain prohibited from engaging in virtually any commercial – *i.e.*, *nonfinancial* – activities. See 12 U.S.C. § 1843(k).

businesses in some circumstances. Section 106 was intended to address these concerns. A bank-specific tying prohibition helped “provide specific statutory assurance that the use of the economic power of a bank will not lead to a lessening of competition or unfair competitive practices.”<sup>14</sup> Congress therefore enacted section 106 even though section 1 of the Sherman Act already applied to the extension of credit, as the Supreme Court had recently affirmed in its tying analysis in *Fortner Enterprises, Inc. v. United States Steel Corp.*<sup>15</sup> In subsequent years, Congress expressly extended the antitying restrictions of section 106 to certain other kinds of banks – such as industrial loan companies, credit card banks, and trust companies – that are owned by investment banks and other companies that are not otherwise regulated as bank holding companies.<sup>16</sup>

In circumstances where they apply, the antitying restrictions of section 106 have often been interpreted as applying more stringently than the antitying restrictions imposed by the antitrust laws. To establish a tying violation of the Sherman Act, the plaintiff must demonstrate that the defendant has “market power” in the tying product and that the tie produced anticompetitive effects.<sup>17</sup> In contrast, section 106 frequently has been interpreted as requiring neither showing,<sup>18</sup> although some courts have found more overlap between the antitying requirements of section 106 and the antitrust laws.<sup>19</sup> Based upon the more restrictive interpretation of section 106, some have characterized the provision as imposing an unusually strict standard to establish a violation, *i.e.*, it need only be shown that a bank conditioned the availability or price of a tying product on a customer’s obtaining some other product from the bank or its affiliates.<sup>20</sup>

Despite this unusually strict standard, however – or perhaps because of it – the scope of application of section 106 has been limited in a number of important ways. First, as

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<sup>14</sup> S. REP. NO. 91-1084, at 16 (Aug. 10, 1970).

<sup>15</sup> 394 U.S. 495 (1969).

<sup>16</sup> *See, e.g.*, 12 U.S.C. § 1843(h).

<sup>17</sup> *See Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 13-16 (1984) (elements of tying violation under Sherman Act). Some courts, however, have held that no showing of anticompetitive effect is required for a claim of tying based on a *per se* (as opposed to rule of reason) analysis. *See, e.g., Amey, Inc. v. Gulf Abstract & Title, Inc.*, 758 F.2d 1486, 1503 (11th Cir. 1985).

<sup>18</sup> *See, e.g., Dibidale of Louisiana, Inc. v. American Bank & Trust Co.*, 916 F.2d 300, 305 (5th Cir. 1990) (no requirement to prove market power or anticompetitive effect under section 106).

<sup>19</sup> *See, e.g., Davis v. First Nat’l Bank of Westville*, 868 F.2d 206, 208 (7th Cir. 1989) (“[E]ven under this ‘relaxed’ *per se* approach to banking tie-ins, a plaintiff seeking relief under section 1972 must still complain of a practice that is *anticompetitive*” (emphasis added).); *Parsons Steel, Inc. v. First Alabama Bank of Montgomery*, 679 F.2d 242, 246 (11th Cir. 1982) (“[Section 106] is intended to prohibit *anticompetitive* tying arrangements . . . other uses of a bank’s economic power to protect its investments are not affected by the Act.” (emphasis added)).

<sup>20</sup> *See Dibidale*, 916 F.2d at 304-05; *Swerdloff v. Miami Nat’l Bank*, 584 F.2d 54 (5th Cir. 1978); *Gage v. First Fed. Savings and Loan Ass’n*, 717 F. Supp. 745 (D. Kan. 1989).

discussed, the statutory traditional bank product exception permits banks to condition the availability of any bank product, such as an extension of credit, on customers' purchase of a loan, discount, deposit, or trust service from that bank.<sup>21</sup> This important exception, which was added by the only significant amendment to the provision that had been reported out of the Senate Banking Committee, was specifically intended to "preserve the benefits to the public of banks being able to compete in appropriate related services."<sup>22</sup> Second, Congress provided the Federal Reserve Board with authority to issue exemptions from section 106 where such exemptions would not be contrary to the purposes of the tying provisions.<sup>23</sup> As discussed more fully below, the Board has invoked this authority frequently, particularly in the context of volume-based pricing arrangements such as combined-balance discounts. Third, the Board promulgated the "regulatory" traditional bank product exception, which permits a bank or bank holding company to offer a discount on a bank product on the condition that customers obtain a traditional bank product from an *affiliate* (as opposed to obtaining it from the bank itself, a practice which is expressly permitted by the statutory exception).<sup>24</sup>

Finally, in 1997 the Board eliminated its previous extension of section 106 to cover nonbank subsidiaries of bank holding companies. Although the statute by its terms restricts the tying activities only of banks, the Board in 1971 had extended the restriction by regulation to the tying activities of *nonbank* subsidiaries of bank holding companies.<sup>25</sup> In rescinding that regulatory extension in 1997, the Board expressly recognized that the antitrust laws were sufficient to regulate such activities: "Any competitive problems that might arise would be isolated cases, better addressed not through a special blanket prohibition but rather through the same general antitrust laws that bind the non-bank-affiliated competitors of these entities."<sup>26</sup>

Taken together, the exceptions to section 106, combined with express legislative history recognizing that its restrictions were not intended to interfere with relationship banking, confirm that the scope of the provision is targeted and limited: it prohibits a bank from requiring customers to obtain a specific non-traditional bank product as a condition for receiving other bank services. In all other circumstances, the generally applicable antitrust laws provide adequate protection with respect to bank tying activities.

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<sup>21</sup> 12 U.S.C. § 1972(1)(A).

<sup>22</sup> Cong. Rec. S15713 (Sept. 16, 1970) (statement of Senator Bennett).

<sup>23</sup> See 12 U.S.C. § 1972(1).

<sup>24</sup> See 59 Fed. Reg. 39,677 (Aug. 4, 1994) (final rule at 12 C.F.R. § 225.7).

<sup>25</sup> See Nonbanking Activities of Bank Holding Companies, 36 Fed. Reg. 10,777, at 10,778 (June 3, 1971) (formerly codified at 12 C.F.R. § 222.4(c)).

<sup>26</sup> 62 Fed. Reg. 9,290, at 9,313 (Feb. 28, 1997).

### C. Analysis of Different Relationship Banking Scenarios

Relationship banking is a broad term that can encompass a variety of different practices. Here, we review the legality of seven scenarios that illustrate the scope and application of the bank tying prohibition. Together, these scenarios and our related analysis demonstrate that section 106 prohibits only a narrow subset of the practices commonly thought of as relationship banking.

#### 1. Scenario #1: Customer Requests Multiple Products

**Facts:** In this first scenario, the Customer takes advantage of full-service banking by purchasing multiple products from a Bank and/or its affiliates without any prompting from the Bank. For example, a business customer obtains traditional bank products (such as loan and deposit services) from a Bank, and also opts to do insurance or investment banking business with affiliates of the Bank. In this scenario, there is no express or implicit connection between the pricing or availability of the products offered by the Bank and its affiliates.

**Analysis:** Clearly, this scenario does not present a tying problem. By its plain language, section 106 applies only to situations in which a bank imposes a “condition or requirement” on the price or availability of product.<sup>27</sup> Here, there is no condition or requirement imposed by either party. The customer has chosen to purchase multiple products, and that fact has no tying implications whatsoever.

#### 2. Scenario #2: Customer Conditions Purchase of Bank Product on Obtaining Additional Product (Customer-Initiated Tie)

**Facts:** The Customer purchases multiple products from a Bank and/or its affiliates, but in this instance, the Customer seeks to obtain more favorable terms based on its purchase of multiple services. For example, the Customer might request a discount on one or more products based on the overall volume of business that it is doing with the Bank and its affiliates. Or, the Customer might condition its purchase of one product on the Bank’s provision of another product – for instance, by telling the Bank that it will use the Bank’s affiliate for investment banking services only if the Bank provides a commercial loan. In each case, of course, the Customer’s request is genuinely voluntary, and there is no express or implied coercion by the Bank. This scenario differs from Scenario #1 in that there is a linkage – one initiated by the Customer – between the multiple products that the Customer obtains.

**Analysis:** In contrast to the first scenario, customers here not only purchase multiple products, but seek to leverage their relationship with banks to obtain more favorable terms. Thus, while there is a tie, it is initiated by the customer. Such customer-initiated tying clearly is permissible under section 106.

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<sup>27</sup> 12 U.S.C. § 1972(1).

Section 106 provides that “[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” that the customer agree to purchase another product or service, refrain from purchasing a product or service from a competitor, and so forth.<sup>28</sup> By its plain language, the provision applies to conditions or requirements imposed by a bank, not by a customer. And, the Federal Reserve Board, consistent with section 106’s language, has repeatedly referred to the importance of preserving “a customer’s ability to negotiate the price of multiple banking services with the bank on the basis of the customer’s entire relationship with the bank.”<sup>29</sup>

In short, section 106 clearly permits customer requests for the packaging and discounting of bank services, including non-traditional bank products, as part of the customer’s overall relationship with a bank. As long as such a customer request involves neither express nor implied coercion by the bank, it does not violate section 106.

### 3. Scenario #3: Bank Terminates Relationship with Insufficiently Profitable Customer

**Facts:** The Bank or Bank Holding Company decides that its overall relationship with a Customer is not sufficiently profitable to justify continuing to do business with the Customer and therefore terminates the business relationship. In essence, the banking organization determines that the overall rate of return from the relationship does not clear its internal “hurdle rate,” meaning the Bank or Bank Holding Company could obtain a better rate of return by committing its resources elsewhere. The Bank therefore declines to renew an existing line of credit. (Or, if it is a new Customer, the Bank declines to extend credit in the first place.) In this scenario, the Bank or Bank Holding Company simply informs the Customer that it cannot offer the requested product – typically, commercial credit – without the Bank in any fashion proposing alternative products that, if selected, might clear the hurdle rate.

**Analysis:** The bank tying prohibition does not affirmatively require a bank to do business with any particular customer, including, but not limited to, a customer whose business does not generate an adequate return on capital to make the transaction worthwhile from the perspective of the banking organization. Therefore, the bank’s termination of the relationship does not violate section 106. Indeed, as described below in Scenario #5, section 106 expressly permits a bank to provide a product on the “condition or requirement” that the customer also obtain a traditional banking product. If a bank can decline to provide a product unless the

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<sup>28</sup> 12 U.S.C. §. 1972(1) (emphasis added).

<sup>29</sup> *Fleet Financial Group*, 80 Fed. Res. Bull. 1134, 1135 (1994) (emphasis added). See also Letter from Federal Reserve Board Chairman Alan Greenspan & Comptroller John D. Hawke, Jr. to Rep. John D. Dingell (Aug. 13, 2002), App. at 4 (acknowledging that “customers may request that banks package services”).

customer also selects another traditional bank product, then it stands to reason that the Bank can decline to provide the product at all.<sup>30</sup>

#### **4. Scenario #4: Nonbank Subsidiary of Bank Holding Company Conditions Product on Customer Obtaining Additional Product**

**Facts:** A Customer seeks a product or service not from a bank, but from a nonbank subsidiary of a bank holding company, such as securities underwriting services from a securities underwriter that is affiliated with the bank. The Securities Underwriter flatly tells the Customer that it will not provide the securities underwriting services (or will provide it on less favorable terms) unless the Customer obtains a product from its affiliate, which could be either a bank or nonbank subsidiary of the bank holding company. Or, a nonbank subsidiary of a bank holding company that makes commercial loans (“Commercial Lending Subsidiary”) indicates that it will provide a “bridge loan” to the Customer that can be repaid from the proceeds of securities to be issued by the Customer in the future – but only if the securities are underwritten by a securities underwriter affiliated with the Commercial Lending Subsidiary. In neither example does a *bank* condition *its* products on the Customer’s obtaining additional products.

**Analysis:** By its express terms, the text of section 106 has always applied only to conditions or requirements imposed by “a bank.” Nevertheless, as described above, the Federal Reserve Board extended the prohibition of section 106 to nonbank subsidiaries of bank holding companies in 1971, but rescinded that extension in 1997 in recognition of the fact that “[a]ny competitive problems that might arise would be . . . better addressed . . . through the same general antitrust laws that bind the non-bank-affiliated competitors of these entities.”<sup>31</sup> Accordingly, under section 106, a nonbank subsidiary of a bank holding company may flatly condition the availability of a product, including a commercial bridge loan, on the customer’s agreement to obtain an additional product or service from an affiliated bank or nonbank, including securities underwriting or investment banking services. Moreover, the tying of bridge loans to securities underwriting business is an activity in which nonbank competitors of banking organizations – including major investment banking firms – routinely and openly engage as standard industry practice.

#### **5. Scenario #5: Bank Conditions Product on Customer Obtaining Traditional Bank Product**

**Facts:** A Customer seeks a product from a Bank and is explicitly told that, in order to obtain the desired product, the Customer must also obtain from the Bank or its affiliate

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<sup>30</sup> A bank’s right to decline insufficiently profitable business is also implicitly recognized in a recent joint letter from the Federal Reserve Board and the OCC, which observed that banks have, “in some cases, [been] terminating established credit lines when overall customer relationships do not return sufficient revenues for the risks undertaken.” Nowhere is it suggested that such termination of a relationship itself violates the bank tying provisions. Letter from Federal Reserve Board Chairman Alan Greenspan & Comptroller John D. Hawke, Jr. to Rep. John D. Dingell (Aug. 13, 2002), App. at 4.

<sup>31</sup> 62 Fed. Reg. 9,290, at 9,313 (Feb. 28, 1997).

some other “traditional bank product.” For example, a Customer seeks a commercial loan from the Bank, and the Bank agrees to provide it only on the express condition that the Customer also use the Bank for its cash management services.

**Analysis:** This practice is expressly permitted under section 106. As noted, the statutory traditional bank product exception, added by amendment on the Senate floor, permits a bank to condition its provision of a product or service on the customer’s obtaining a separate, traditional bank product from that bank, *i.e.*, a “loan, discount, deposit, or trust service.”<sup>32</sup> In 1994, the Board extended the traditional bank product exception to cover arrangements where the tied traditional bank product is provided by an affiliate rather than the bank itself.<sup>33</sup> Thus, under section 106, as a condition for customers to receive loans, a bank may expressly require such customers to purchase a traditional bank product provided by the bank or an affiliate, such as cash management services.

**6. Scenario #6: Bank Conditions Product on Customer Obtaining Either Traditional or Non-Traditional Bank Products, at Customer’s Choice**

**Facts:** The Customer seeks a Bank product such as a commercial loan. As in Scenario #3, the Bank determines that offering the loan as a stand-alone product is not sufficiently profitable to justify committing its capital in that manner. Rather than simply decline to extend the loan, however, the Bank offers the Customer a choice of other products offered by the Bank and/or its affiliates, and informs the Customer that if the Customer chooses an additional product from the “menu” of choices, the relationship would be sufficiently profitable to allow the Bank to make the loan. The menu includes both traditional bank products and non-traditional bank products. For example, the Customer is given a choice of products that includes traditional bank products such as deposit and cash management products and non-traditional products such as investment banking services from the Bank’s securities affiliate.

**Analysis:** This arrangement is lawful under both the plain language of section 106 and the legislative history, regulatory guidance, and case law interpreting that provision.

**a) Statutory text**

The plain language of section 106 does not proscribe the arrangement, provided that each of the traditional bank products represents a meaningful customer choice. A “meaningful choice” in this context means that it is genuinely possible for customers to clear the bank’s hurdle rate by selecting only products that qualify for the traditional bank product exception. As described in scenario #5 above, clearly the bank would be free to condition a loan on the customers obtaining *only* traditional bank products. By also giving customers the *option* of obtaining a non-traditional bank product instead, the Bank is merely providing them *greater*

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<sup>32</sup> 12 U.S.C. § 1972(1)(A).

<sup>33</sup> See 59 Fed. Reg. 39,677 (Aug. 4, 1994) (final rule at 12 C.F.R. § 225.7) (regulatory traditional bank product exception).

*choice* than if they were required to choose only from traditional bank product options – an approach that clearly would be permissible. More fundamentally, in such circumstances there is no “condition or requirement” within the meaning of section 106 that customers accept a non-traditional bank product in order to obtain bank loans – which would be a violation of the statute – because customers remain free *not* to obtain such a product by choosing a traditional bank product instead.

## **b) Legislative history**

The legislative history supports the legality of the meaningful choice approach in two distinct ways. First, Congress’s enactment of the traditional bank product exception made clear its intention that section 106 apply only to the tying of non-traditional products, and was expressly not intended to interfere with relationship banking. Second, the amendment of the bank tying provision’s original “condition, agreement, or understanding” standard to the narrower “condition or requirement” clarified that section 106 applies only where the customer is genuinely *required* to accept a non-traditional bank product.

### **(1) Traditional bank product exception and relationship banking**

In introducing the amendment that resulted in the adoption of the traditional bank product exception, Senator Bennett stated that it “will, among other things, enable the customer to continue to negotiate his costs and fees with the bank *on the basis of his entire relationship with the bank*, as the committee report points out at page 17. *Clearly, neither a bank nor its customer should be attacked under [the tying prohibition] for taking advantage of the economies and efficiencies of full-service banking.*”<sup>34</sup> Later in the debate, Senator Bennett remarked that the exception “would preserve the benefits to the public of banks being able to compete in appropriate related services.”<sup>35</sup> Further, “[i]t must be recognized by all who seriously study our economy that there is a tendency to establish one-stop shopping, whether it be for groceries or financial services.”<sup>36</sup>

The Senate Report (the key committee report addressing section 106) also recognizes that the traditional bank product exception is designed to minimize interference with relationship banking practices. “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.”<sup>37</sup>

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<sup>34</sup> Cong. Rec. S15708 (Sept. 16, 1970) (emphasis added).

<sup>35</sup> *Id.* at S15713.

<sup>36</sup> *Id.*

<sup>37</sup> SEN. REP. NO. 91-1084, at 17 (Aug. 10, 1970); *accord* Cong. Rec. S15547 (Sept. 15, 1970) (same comments by Chairman Sparkman in floor statement).

These sentiments were echoed in the House floor debate. Representative Widnall introduced a letter from Deputy Attorney General Kleindienst to Chairman Patman stating that, as a result of the traditional bank product exception, “the anti-tying clause constitutes no threat to what has come to be known as ‘full-service’ banking.”<sup>38</sup> Again, it is evident that Congress considered it necessary to clarify that section 106 prohibits only a condition or requirement to purchase specific *non-traditional* bank products, and was not intended to interfere with the type of relationship banking that facilitates customer choice among a range of products and services provided by a single banking organization.

## (2) Enactment of the “condition or requirement” standard

As enacted, the restrictions of section 106 apply only where a bank provides or discounts a product on the “condition or requirement” that customers obtain some additional product. However, the earlier version of the legislation reported by the Senate Banking Committee had a broader “condition, agreement or understanding” standard.<sup>39</sup> The narrower “condition or requirement” standard that was ultimately enacted was the result of a Senate floor amendment sponsored by Senator Bennett.

The Bennett amendment clarified that a mere “understanding or agreement” would not be enough to trigger a violation; instead, there had to be the type of coercion inherent in a “condition or requirement,” as opposed to situations in which customers can exercise choice. As Senator Bennett explained:

The elimination of the words “condition or understanding,” [sic]<sup>40</sup> and the substitution of the word “requirement,” *are intended to eliminate possible inferences and implications of tie-ins and exclusive dealing arrangements 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 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.*<sup>41</sup>

Thus, the legislative history focuses on the need for a genuine “condition or requirement” that *forces* customers to obtain a specific non-traditional bank product in order to obtain a banking product. If customers are always provided the meaningful option of choosing solely traditional bank products as the condition for obtaining another bank product such as a

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<sup>38</sup> Cong. Rec. H11793 (Dec. 16, 1970).

<sup>39</sup> H.R. 6778, 91st Cong. § 104(b) (1970) (as reported August 10, 1970 by Senate Committee on Banking and Currency).

<sup>40</sup> In fact, the words “agreement or understanding” were eliminated, not “condition or understanding,” as mistakenly stated by Senator Bennett.

<sup>41</sup> Cong. Rec. S15708 (Sept. 16, 1970) (emphasis added).

loan, then by definition there is no “condition or requirement” that customers obtain a non-traditional product. Accordingly, the legislative history strongly supports the conclusion that the meaningful choice approach of this scenario does not violate section 106.

### c) Regulatory guidance

The Federal Reserve Board has frequently exercised its authority to grant exemptions in a manner that supports the legality of arrangements in which customers have a meaningful choice.<sup>42</sup> Generally, these interpretations have involved volume-based discounts in which the eligible qualifying items include non-traditional bank products or services.

In its 1994 *Fleet* order, the Board granted an exemption from section 106 for Fleet’s combined balance discount program. The program provided fee discounts to customers who maintained a minimum combined balance in two or more eligible accounts from a menu that contained both traditional and non-traditional products, such as mutual fund shares. The Board observed that under Fleet’s program, customers benefited from greater choice as a result of the addition of non-traditional bank products to the menu: “[T]he requested exemption would simply permit Fleet to increase customer choice by adding a customer’s securities brokerage account balance at Fleet Brokerage . . . to the menu of traditional bank products that count toward the minimum balance . . . .”<sup>43</sup> Moreover, customers could obtain the discount based solely on traditional bank products, if they so chose. Therefore, the proposal was not “coercive, anticompetitive, or otherwise inconsistent with the purposes of section 106.”<sup>44</sup> A year later, when it promulgated a regulatory safe harbor that essentially codified the *Fleet* holding subject to certain conditions, the Board concluded that “any exempt combined-balance discount would offer customers *meaningful choices and therefore could not have an anti-competitive effect.*”<sup>45</sup>

Subsequently, the Board has repeatedly issued guidance reaffirming the permissibility of relationship-based conditions in which customers, because of meaningful choice to select traditional bank products in order to obtain discounts, have not been coerced into accepting non-traditional bank products. See, e.g., *Citibank* (combined balance program

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<sup>42</sup> Although most of the Board’s guidance on section 106 has come in the form of exemptions rather than interpretations, the Board has often noted that it was issuing an exemption to provide regulatory certainty even where an arrangement might otherwise be deemed legal. See, e.g., FRB Interp. Ltr., 1999 WL 1580990, at \*2 (Dec. 7, 1999) (proposed retailer card program does not violate section 106, but Board will propose exception “to provide more certainty in this area”); Huntington Bancshares, 1996 WL 275365, at \*3 (May 23, 1996) (“To the extent that the Applicants’ [floorplan loan discount] proposal is not already permitted, the Board has concluded that an exemption to permit the entire proposal is consistent with the purposes of section 106.”).

<sup>43</sup> *Fleet Financial Group*, 80 Fed. Res. Bull. 1134, 1135 (1994).

<sup>44</sup> *Id.* at 1135-36 (emphasis added).

<sup>45</sup> 60 Fed. Reg. 20,186, at 20,188 (Apr. 25, 1995) (emphasis added). The Board’s commentary reiterated the significance of customer choice: “The proposed safe harbor would simply permit a bank to increase customer choice by adding a customer’s securities brokerage account or other non-traditional products to the menu of traditional bank products that count toward the minimum balance.” *Id.* at 20,187 n.3.

permissible because it “offers meaningful choices to customers” and “would not directly or indirectly cause customers to use non-traditional products . . . .”<sup>46</sup> *NationsBank* (because of customer’s ability to obtain banking services without obtaining non-traditional bank products, proposed discount arrangement “does not raise the concerns about coercion and anti-competitiveness that section 106 was intended to address”);<sup>47</sup> *Huntington Bancshares* (“[a]llowing the proposed arrangement would serve this purpose by allowing Applicants to offer volume discounts to dealerships based on their relationship with the bank holding company”);<sup>48</sup> and 1997 revisions to Regulation Y (“[T]he Board has allowed arrangements that included discounts on brokerage services and other products based [upon] 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.”).<sup>49</sup>

Thus, the Federal Reserve Board has approved numerous arrangements in which banks package and discount products on the basis of the extent of the customers’ entire business relationship with the banking organizations. Although the specifics of the programs have varied, a common element has been that the arrangements preserved meaningful customer choice of traditional bank products in the context of relationship banking and therefore did not present coercive or anticompetitive concerns.

#### d) Case law

There are few reported cases dealing in a substantial way with the scope of section 106 that would be relevant to relationship banking. Instead, most have involved challenges by individual borrowers or small businesses to the validity of credit-related requirements that banks have imposed as conditions for providing loans, such as required posting of additional collateral. While borrowers in such cases have typically argued that *any* condition on obtaining a bank loan violates a strict interpretation of section 106, courts have usually upheld such credit-related conditions as reasonable protections against default.<sup>50</sup>

Nevertheless, the limited case law that is relevant to relationship banking supports the notion that unlawful tying cannot exist if customers have a choice of whether to obtain the tied product. For example, in *Stefiuk v. First Union National Bank of Florida*,<sup>51</sup> the plaintiff argued that the bank engaged in an unlawful tie when it conditioned free check cashing on his opening a bank account, even though he could also avoid check cashing fees by obtaining a

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<sup>46</sup> *Citibank, N.A.*, FRB Interp. Ltr., at 3 (Dec. 6, 1996) (emphasis added).

<sup>47</sup> *NationsBank Corp.*, 1997 WL 1138814, at \*3 (F.R.B. Sept. 19, 1997) (emphasis added).

<sup>48</sup> *Huntington Bancshares*, 1996 WL 275365, at \*3 (F.R.B. May 23, 1996) (emphasis added).

<sup>49</sup> 62 Fed. Reg. 9290, at 9313 (Feb. 28, 1997).

<sup>50</sup> See, e.g., *Continental Bank v. Barclay Riding Academy*, 459 A.2d 1163 (N.J. 1983) (unusual loan conditions related to bank’s security as lender did not violate section 106).

<sup>51</sup> 61 F. Supp. 2d. 1294 (S.D. Fl. 1999), *aff’d* 207 F.3d 664 (11th Cir. 2000).

check cashing card. In addition to observing that the bank’s practices were likely permitted by the traditional bank products exception, the court denied plaintiff’s claim based on the more fundamental determination that no tie existed in the first instance. That is, because of the choice involved in being able to obtain the check cashing card, the court held that there was no tie because plaintiff “was not ‘forced’ to get the ‘tied’ product — opening an account.”<sup>52</sup> A similar result was reached in *Integon Life Ins. Corp. v. Browning*,<sup>53</sup> in which the court upheld summary judgment against a plaintiff who failed to provide evidence of coercion. The court emphasized that an unlawful tie occurs only when the plaintiff is, in fact, “forced to buy the tied product to obtain the tying product.”<sup>54</sup> Where customers have the option of obtaining the tying product by selecting a traditional bank product or a non-traditional bank product, no such coercion is present.

Thus, the relevant case law, while quite limited, is fully consistent with the permissibility of relationship banking where customers have meaningful choice regarding other products and services.

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A bank clearly may condition a loan on customers obtaining another product that is a traditional bank product. Because of that fact, changing the arrangement to allow customers to choose *either* a traditional bank product *or* a non-traditional bank product to obtain the loan would not violate section 106, so long as the traditional bank product constituted a genuine or meaningful choice. In this second set of circumstances, customers are simply provided more choice than in the first, and thus there is no “condition or requirement” that customers obtain non-traditional bank products in violation of the statute. Of course, whether in any individual scenario a choice is meaningful will depend on the particular products involved and surrounding circumstances.

**7. Scenario #7: Tie of Desired Product to Non-Traditional Bank Product**

**Facts:** A Customer seeks to obtain a product of any kind from the Bank. The Bank responds by telling the Customer that, in order to obtain the desired product (or obtain it on the desired terms), the Customer must also purchase a non-traditional bank product from the Bank or one of its affiliates. For example, a Customer seeks a loan; the Bank responds that it will provide the loan only if the Customer also purchases an insurance policy from the Bank’s affiliate. Or, a customer seeks a line of credit, and the Bank responds that it will provide the credit only if the Bank’s securities affiliate participates in the underwriting of the customer’s next securities offering.

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<sup>52</sup> *Id.* at 1299.

<sup>53</sup> 989 F.2d 1143 (11th Cir. 1993).

<sup>54</sup> *Id.* at 1151 (emphasis added). The court also noted that its holding conflicted with the Fifth circuit’s statement that section 106 is not limited to arrangements in which the customer is “literally forced” to purchase the tied bank product. *Id.* at 1151 n.20 (quoting *Dibidale*, 916 F.2d at 306).

**Analysis:** Unlike Scenario #6, here the customer has no option to choose a traditional product to obtain the first product, as permitted by section 106. Instead, the bank is imposing a genuine “condition or requirement” that customers must obtain a specific additional product that does not fall within the traditional bank product exception.<sup>55</sup> Accordingly, where a bank imposes such a condition or requirement, this scenario necessarily violates the strict interpretation of section 106.

**D. Conclusion**

Although relationship banking has recently received heightened public scrutiny, it is a longstanding practice that was expressly recognized by Congress as appropriate at the time that the bank tying prohibition was enacted in 1970. Indeed, appreciating the benefits of relationship banking, Congress narrowly crafted section 106 to preserve the freedom of banks and their customers to negotiate on the basis of the customer’s overall relationship with the bank. The most prominent examples of this limited scope are the traditional bank product exception and the Federal Reserve Board’s broad authority to issue exemptions. Over the years, the Board has recognized the targeted scope of section 106, which is to prohibit tying arrangements that specifically condition the price or availability of a product on a customer obtaining a non-traditional bank product, and has therefore approved relationship banking programs that provide meaningful choices to customers among traditional and non-traditional bank products.

Against this backdrop, banking organizations have engaged in a wide variety of relationship banking practices over the years by bundling products both for and at the request of their customers, including circumstances in which customers may choose as their bundled products either traditional or non-traditional bank products. In this memorandum, we have analyzed six such relationship banking scenarios that we understand to be typical practices of banking organizations, and we conclude that each is a permissible activity that falls outside the targeted prohibitions of section 106. A seventh scenario that consists of conditioning a bank product on obtaining a specific *non*-traditional bank product would violate the strict interpretation of that provision.

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<sup>55</sup> See 12 U.S.C. § 1972(1)(A).