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**Have You Forgotten About Tying? The Banking Agencies Have Not**

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By Isaac Lustgarten

While Congress, the securities regulators and the New York attorney general have focused on the links between analyst research reports and investment banking business, Congress and the press have turned their attention on another "pay to play" issue: whether the pricing of credit is being manipulated by commercial banks to build market share in investment banking.

There is concern over the increased concentration among corporate lenders and over highly publicized examples of banks that dropped credit facilities when they were not granted sufficient investment banking business in exchange - the illegal practice of tying.

A bank may not extend credit, lease, or sell property of any kind or furnish any service or fix or vary its consideration of a customer on the condition or requirement that the customer obtain some additional credit, property, or service from the bank (other than a loan, discount, deposit, or trust service - traditional banking products) or from an affiliate of it. Nor can banks condition their services on a customer's not obtaining services from its competitors. Arguably, tying traditional banking products to one another is permissible.

Moreover, banks may not extend credit to a borrower at terms that are below-market or are not at arm's length where an affiliate, including an underwriting affiliate, is a participant in the transaction or where the loan's proceeds are used for the benefit of an affiliate. Therefore a bank may not offer credit at below-market rate as a "loss leader" to induce a prospective customer to use the bank's underwriting affiliate. During routine examinations, both the Federal Reserve and the Office of the Comptroller of the Currency are expected to evaluate a banking organization's compliance with the tying provisions.

Congress adopted anti-tying provisions because of what it perceived as the unique economic power of banks to extend credit. Unlike the antitrust laws, Section 106 imposes treble damages for violations. Congress is urging the regulators to ask corporate financial executives whether they feel pressure to award investment banking or other services as a condition of obtaining loans from commercial banks. The Fed and the OCC are reviewing banks' anti-tying-related training and compliance, marketing programs, and internal audits.

The anti-tying rules do not apply directly to bank holding companies, which may cross-market the services of their bank and nonbank affiliates by offering products and services on a linked or packaged basis. A nonbank affiliate may require purchasers of its services to use affiliated bank products, for example, and may even require customers to refrain from using competitors' services. Any such tying arrangements, however, would be subject to the antitrust laws.

Banking organizations have been increasingly rationalizing their product pricing in recent years by charging higher spreads on credit facilities, tightening loan terms and conditions, and, in some cases, terminating established credit lines when overall customer relationships do not return sufficient revenues for the risks undertaken.

Banks may have the incentive to let the profits from cash management, investment banking, and other services cloud their objectivity in evaluating borrower risk. Proposed revisions to the new Basel accord, and related risk management objectives, seek to ensure that banks enhance the checks and balances to guarantee the integrity of internal credit rating systems. These are high priorities at the banking agencies.

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