

# CADWALADER

*Cadwalader, Wickersham & Taft LLP*

100 Maiden Lane  
New York, NY 10038  
Tel: 212 504-6000  
Fax: 212 504-6666

New York  
Charlotte  
Washington  
London

## MEMORANDUM

**To:** Clients & Friends

**From:** Cadwalader, Wickersham & Taft LLP

**Date:** September 10, 2003

**Re:** Anti-Tying Restrictions of Section 106 of the Bank Holding Company Act Amendments of 1970

---

---

The Board of Governors of the Federal Reserve System (the “**Board**”) recently released a proposed official interpretation of the anti-tying restrictions of Section 106 of the Bank Holding Company Act Amendments of 1970 (“**section 106**” and the “**Act**”, respectively).<sup>1</sup> Section 106 generally prohibits a bank<sup>2</sup> from conditioning the availability or price of one product on a requirement that the customer also obtain another product from the bank or an affiliate of the bank.<sup>3</sup>

---

<sup>1</sup> The bank anti-tying provisions are codified at 12 U.S.C. 1971-1978.

<sup>2</sup> Virtually every type of U.S. institution that is chartered as a bank is subject to section 106. This includes grandfathered nonbank banks, nonbank trust companies, credit card banks, Edge Act and Agreement Corporations and industrial loan companies that are not “banks” that would subject the parent to treatment as a bank holding company under the Bank Holding Company Act of 1956, as amended (the “**BHC Act**”), but are nonetheless subject to the anti-tying provisions of section 106. See 12 U.S.C. 1843(f)(9) (grandfathered nonbank banks) and 1843(h) (other exempt institutions). In addition, although nonbank affiliates of a bank and other nonbank entities generally are not subject to section 106, the parent company of these listed institutions (which today include most major investment houses and commercial lending companies) and their affiliates each become subject to the bank anti-tying provisions in connection with any transaction involving the products of the parent or its affiliate and of the listed institution as if the parent or affiliate were a bank and the institution were an affiliate. Section 106 also applies to any U.S. branch, agency, or commercial lending company of a foreign bank (as those terms are defined in section 8 of the International Banking Act). See 12 U.S.C. §3106.

Section 106 also applies to all subsidiaries of a bank--other than a “financial” subsidiary--in exactly the same manner as the statute applies to the bank itself. A financial subsidiary of a national bank or a state member bank, however, is treated as an affiliate of the bank, and not as a subsidiary of the bank, for purposes of the statute. The Board has also proposed to treat financial subsidiaries of state non-member banks as affiliates of the parent bank for purposes of section 106. Financial subsidiaries constitute a narrow class of subsidiaries (such as securities underwriting firms) that engage in activities authorized for financial holding companies under the Gramm-Leach-Bliley Act, but which are bank subsidiaries. This does not include normal bank “operating subsidiaries” that engage in activities permissible for the bank itself.

The nonbank affiliates of banks, as well as banks themselves, however, are subject to the anti-tying restrictions contained in the United States Federal antitrust laws (the Sherman and Clayton Acts).

<sup>3</sup> The Proposal was published in the Federal Register on August 29, 2003, 68 Federal Register 52024-52035. Comments are due by September 30, 2003.

The bank anti-tying provisions are significantly more stringent than the Sherman and Clayton Act anti-tying restrictions. The bank rules require no showing of market power over the tying product, usually credit, and provide for civil treble damages actions and injunctive relief, as well as regulatory administrative enforcement. The bank regulators have in the past examined institutions for compliance with these rules, but had not initiated many regulatory actions based on section 106. Most litigation in this area arises out of defaulted loans, in which the anti-tying rules are asserted as a counterclaim. However, the Board punctuated its proposed interpretation with the almost simultaneous issuance of a \$3 million civil penalty against a depository institution for anti-tying violations stemming from its conditioning extensions of credit and varying the fees for the credit on the client's agreement to obtain securities underwriting services from the institution.<sup>4</sup>

The Board's proposed interpretation of section 106 is intended to provide banking organizations and their customers with a comprehensive guide to the special anti-tying restrictions applicable to banks. The related supervisory guidance describes the types of policies and procedures that should help banks ensure and monitor their compliance with section 106. The Board has requested public comment regarding the proposal by September 30, 2003. This memorandum is a summary of the basic elements of section 106 and the Board's proposal.

## **Background**

The United States Congress adopted section 106 in 1970 at the same time that it expanded the ability of bank holding companies to engage in nonbanking activities under section 4(c)(8) of the Bank Holding Company Act (BHC Act). Congress expressed concern that banks might use their ability to offer bank products—credit in particular—in a coercive manner to gain a competitive advantage in markets for nonbanking products and services (such as securities underwriting). Congress therefore decided to impose the special anti-tying restrictions in section 106 on banks.

Although section 106 prohibits banks from imposing certain types of tying arrangements on their customers, the statute also expressly exempts some tying arrangements and authorizes the Board to grant additional exceptions to the statute's restrictions by regulation or order. A key exemption, which would be enhanced by the Board's current interpretation, allows a bank to condition the availability or price of a product or service on a requirement that the customer also obtain a "loan, discount, deposit, or trust service" (a "**traditional bank product**") from the bank or an affiliate of the bank.

## **What Conduct is Prohibited by Section 106?**

Section 106 prohibits a bank from extending credit, leasing or selling any property or furnishing any service, or fixing or varying the consideration for any of the foregoing, on the condition or requirement that the customer do any of the following:

1. Obtain some additional credit, property or service from the bank, other than a traditional bank product;
2. Provide some additional credit, property or service to the bank, other than those related to and usually provided in connection with a traditional bank product;

---

<sup>4</sup> See FRB Order to Cease and Desist and Order of Assessment of Civil Money Penalty Issued Upon Consent dated August 27, 2003.

3. Obtain from or provide to an affiliate of the bank some additional credit, property or service; or
4. Not obtain some additional credit, property or service from a competitor of the bank or from a competitor of an affiliate of the bank, unless the condition is reasonably imposed in a credit transaction to ensure the soundness of the credit.

As this list illustrates, section 106 prohibits banks from imposing certain tying arrangements as well as certain reciprocity and exclusive dealing arrangements on their customers.<sup>5</sup>

Section 106 also prohibits banks from granting certain types of price discounts – that is, varying the price of a product on the condition that the customer purchase one or more other products from the bank or an affiliate.

### **Elements of an Impermissible Tying Arrangement under Section 106**

Although tying arrangements<sup>6</sup> by banks are subject to the general antitrust laws there are only two essential elements that must be shown to establish that a tying arrangement by a bank violates section 106:

- (1) The arrangement must involve two or more separate products: the customer’s desired product(s) and one or more separate tied products; and
- (2) The bank must force the customer to obtain (or provide) the tied product(s) from (or to) the bank or an affiliate of the bank in order to obtain the customer’s desired product(s) from the bank.<sup>7</sup>

If a condition or requirement was voluntarily sought or imposed by the customer, then the arrangement results from the free choice of the customer and no violation of section 106 has occurred. Thus, for example, a violation of section 106 does not occur if a large corporate customer of a bank demands that the bank provide the customer one product (such as a loan) in order for the bank or its affiliates to obtain other business from the customer (such as bond underwriting business), and the bank agrees to the customer’s condition. In such circumstances, it is the customer that is using its business as leverage to obtain the products it desires—an action that does not implicate the purposes or proscriptions of section 106.

---

<sup>5</sup> “Tying arrangements” are arrangements that require a customer to obtain a product from the bank or one of its affiliates as a condition of the bank providing another product to the customer. “Reciprocity arrangements” are arrangements that require a customer to provide a product to the bank or one of its affiliates as a condition of the bank providing another product to the customer. “Exclusive dealing arrangements” are arrangements that require a customer not to obtain a product from a competitor of the bank or a competitor of an affiliate of the bank as a condition of the bank providing another product to the customer.

<sup>6</sup> For ease of reference, the proposal and this summary of the proposal use the phrase “tying arrangement” to refer to all types of tying, reciprocity and exclusive dealing arrangements described in section 106. In addition, although section 106 generally refers to “credit,” “property” or “service” in describing the items sought or required to be obtained from (or provided to) the bank or an affiliate, the proposal and this summary of the proposal use the term “product” to refer to any type of credit, property or service.

<sup>7</sup> The proposal notes that certain types of derivative products, such as interest rate and foreign exchange swaps, often are sold by banks and purchased by customers in connection with lending transactions. The proposal requests comment on how interest rate swaps, foreign exchange swaps, and other derivative products that are often connected with lending transactions should be treated under section 106.

Also, there must be two distinct products. A bank does not violate the anti-tying rules by requiring a customer to obtain (or provide) two or more aspects of a single product from (or to) the bank or an affiliate, or by conditioning the availability or varying the price of a product on the basis of the characteristics or terms of the product.

## **Exceptions to the Anti-Tying Prohibitions of Section 106**

### **Tying Arrangements Involving Traditional Bank Products**

#### **1. Statutory and regulatory exceptions.**

Section 106 specifically allows a bank to condition both the availability and price of any bank product (the desired product) on the requirement that the customer obtain a traditional bank product (the tied product) from the bank.<sup>8</sup> The Board has extended this exception by regulation to include situations where the tied product is a traditional bank product offered by an affiliate of the bank, rather than by the bank itself. Taken together, these exceptions allow a bank to restrict the availability or vary the price of any bank product on the condition that the customer also obtains a traditional bank product from the bank or an affiliate of the bank.

Several facts are important in determining whether the traditional bank product exceptions apply in a given situation. The exceptions are available only if the tied product is a traditional bank product. The availability of the exceptions, however, does not depend on the type of desired product involved; the desired product may or may not be a traditional bank product. Traditional bank products include, among other things, the following:

- All types of extensions of credit, including loans, lines of credit, and backup lines of credit (note that an “extension of credit” for this purpose does not include underwriting, privately placing or brokering debt securities);
- Letters of credit and financial guarantees;
- Lease transactions that are the functional equivalent of an extension of credit;
- Credit derivatives where the bank or affiliate is the seller of credit protection;
- Acquiring, brokering, arranging, syndicating and servicing loans or other extensions of credit;
- All forms of deposit accounts, including demand, negotiable order of withdrawal (“NOW”), savings and time deposit accounts;
- Safe deposit box services;
- Escrow services;
- Payment and settlement services, including check clearing, check guaranty, automated clearing house (“ACH”), wire transfer, and debit card services;
- Payroll services;
- Traveler’s check and money order services;
- Cash management services;
- Services provided as trustee or guardian, or as executor or administrator of an estate;
- Discretionary asset management services provided as fiduciary;

---

<sup>8</sup> The Board’s regulatory exceptions to the section 106 may be found at section 225.7 of the Board’s Regulation Y. 12 C.F.R. 225.7.

- Custody services (including securities lending services); and
- Paying agent, transfer agent and registrar services.

It is important to note that the Board for the first time has provided an extensive, but not exclusive, list of services that fall within the penumbra of traditional bank services. This will be helpful in the future application of the bank anti-tying rules.

## 2. Mixed-product arrangements.

Section 106 does not prohibit a bank from providing a customer the freedom to choose whether to satisfy a condition imposed by the bank through the purchase of one or more traditional bank products or other “non-traditional” products (a “**mixed-product arrangement**”).

If the customer that is offered the mixed-product arrangement has a meaningful option to satisfy the bank’s condition solely through the purchase of the traditional bank products included in the arrangement, then the bank’s offer would not, in fact, require the customer to purchase any non-traditional product from the bank or its affiliates in violation of section 106.

## **Reciprocity Exceptions**

The reciprocity restrictions of section 106 generally prohibit a bank from conditioning the availability or price of a product (the desired product) on a requirement that the customer provide another product (the tied product) to the bank or an affiliate. Section 106, however, contains an exception for situations where the tied product is to be provided to the bank and is “related to and usually provided in connection with a loan, discount, deposit, or trust service” (a “**usually connected product**”). The Board has extended this exception by regulation to include situations where a bank requires the customer to provide a usually connected product to an affiliate of the bank, rather than to the bank itself. Taken together, these exceptions allow a bank to restrict the availability or vary the price of any bank product on the condition that the customer provides a usually connected product to the bank or any affiliate of the bank.

## **Exclusive Dealing Exception**

The exclusive dealing restriction contained in section 106 generally prohibits a bank from conditioning the availability or price of a bank product (the desired product) on a requirement that the customer not obtain another product (the tied product) from a competitor of the bank or a competitor of an affiliate of the bank.

Section 106 contains an exception to its exclusive dealing restriction for situations where the condition was reasonably imposed by the bank in a credit transaction to ensure the soundness of the credit. This exception, like the statutory reciprocity exception, was intended to preserve the ability of banks to take appropriate steps to protect their credit extensions to customers.

## **Regulatory Safe Harbors.**

### 1. Combined-balance discount safe harbor.

The Board has granted a regulatory safe harbor for combined-balance discount packages, provided that they are structured in a way that does not, as a practical matter, obligate customers to purchase non-traditional products in order to obtain the discount. This safe harbor allows a bank to vary the consideration for a product or package of products based on a customer’s maintaining a combined minimum balance in certain products specified by the bank if three conditions are met: the bank offers deposits; all deposits are eligible to be counted toward the

minimum balance; and deposits count at least as much as nondeposit products toward the minimum balance. Although the products included in the combined-balance discount program must be specified by the bank, the products may be offered by the bank or by an affiliate of the bank.

2. Foreign transaction safe harbor.

The Board also has granted a regulatory safe harbor for any bank transactions with foreign persons. The foreign transaction safe harbor provides that the anti-tying prohibitions of section 106 do not apply to transactions between a bank and a customer if: (i) the customer is a company that is incorporated, chartered, or otherwise organized outside the United States and has its principal place of business outside the United States (a “foreign company”); or (ii) the customer is an individual who is a citizen of a country other than the United States and is not resident in the United States.

If you have any questions regarding section 106 of the Board’s proposal please contact in London, Jim Croke at +44 207 170 8758 or in New York, Peter Manbeck at +1 212 504 6626 or Larry Fruchtman at +1 212 504 6859.