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Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Re: Docket No. OP-1158

Dear Ms. Johnson:

The ABA Securities Association ("ABASA")[1] submits this letter to the Board of Governors of the Federal Reserve System (the "Board") in connection with section 106 of the Bank Holding Company Act Amendments of 1970 ("section 106") and the Board's proposed interpretation and supervisory guidance regarding section 106 (the "*Proposed Interpretation*").[2] On June 9, 2004, the Association for Financial Professionals (the "AFP") released its "2004 Credit Access Survey: Linking Corporate Credit to the Awarding of Other Financial Services -- Report of Survey Results" (such survey, the "AFP survey;" such report, the "AFP Survey Report"), which received prominent coverage that same day in The Wall Street Journal. The AFP Survey Report claims to show that banks are engaged in widespread illegal tying in violation of section 106. This letter addresses the AFP Survey Report and concludes that its sweeping, and purportedly definitive, conclusions do not hold up under close examination.[3]

The most obvious limitation of the AFP Survey Report is that the AFP survey was not designed in a manner that would take into account the specific facts and circumstances surrounding bank-customer relationships. As the Board stated in the *Proposed Interpretation*, "the specific facts and circumstances surrounding the bank-customer relationship often will be critical in determining whether a prohibited

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1 ABASA is a separately chartered trade association and non-profit affiliate of the American Bankers Association whose mission is to represent before the Congress, the federal government and the courts the interests of banking organizations engaged in underwriting and dealing in securities, proprietary mutual funds and derivatives.

2 68 Fed. Reg. 52024 (Aug. 29, 2003).

3 The American Bankers Association also endorses the views expressed herein.

condition or requirement existed and whether the condition or requirement was imposed or forced on the customer by the bank or was volunteered or sought by the customer."[4] It is not possible to ascertain the competitive landscape confronting the respondents in the AFP survey, for example, whether multiple lenders compete for a respondent's business or whether a respondent itself had the power to demand product linkages (in the form of "reverse tying" discussed below). The "facts and circumstances" context of section 106 does not allow oversimplified "yes" or "no" answers to the AFP survey questions to form the basis for the conclusions that are drawn in the AFP Survey Report.

Clearly, how survey questions are crafted and phrased can have a significant impact on how the questions are answered and the appropriate conclusions to be drawn from the answers. Because the specific facts and circumstances surrounding the respondents' answers to the 13 AFP survey questions are not known, no meaningful and reliable conclusion regarding the occurrence of illegal tying by banks can be drawn from the AFP survey results. It is simply not possible to discern facts from respondents' opinions based on the responses to the AFP survey questions as reported in the AFP Survey Report.

One very important example of the "facts and circumstances" limitations of the AFP Survey Report is that it is impossible to ascertain from any of the findings whether the respondents' answers to the AFP survey questions reflect coercive behavior by banks. It appears from the findings of the AFP Survey Report that none of the AFP survey questions focused on the element of coercion, which is a prerequisite for an illegal tying arrangement.[5] This is a serious and fundamental flaw of the AFP survey.

The AFP Survey Report states that 96 percent of respondents from large companies are "subject to pressure" from their credit providers to award other business.[6] Without being able to determine from the questions and answers whether a respondent was coerced, an entirely plausible interpretation of the answers to the relevant AFP survey questions is that the answers merely present evidence of aggressive marketing by banks, which is perfectly legitimate despite the negative light in which such "pressure" is portrayed in the AFP Survey Report. The Board has stated in the *Proposed Interpretation* that "[c]ross-marketing and cross-selling activities,

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[4] 68 Fed. Reg. at 52029. The General Accounting Office (the "GAO") has also recognized that "[d]etermining whether a tying arrangement is unlawful requires close examination of the specific facts and circumstances of the transactions involved, and lawful practices can easily be mistaken for unlawful tying." GAO Report, *Bank Tying* (Oct. 2003) (the "GAO Report"), at 4.

[5] *See, e.g.,* the *Proposed Interpretation*, 68 Fed. Reg. at 52028-29.

[6] AFP Survey Report at 11.

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."[7]

The findings of the AFP Survey Report are equally troubling in other ways. For example, a "key finding" of the AFP Survey Report is that "[n]early two-thirds of companies with annual revenues greater than $1 billion ["large companies"] (63 percent) indicate that, over the past five years, a commercial bank has denied them credit or changed credit terms because the company did not award other business to the bank."[8] This finding is not necessarily evidence of illegal tying by banks because it could just as easily reflect permissible relationship banking. "[S]ection 106 does not require a bank to extend credit . . . to any customer"[9] and a bank may, without violating section 106, deny credit or change credit terms if a customer's overall relationship with the bank does not meet the bank's internal targeted rate of return. Further, it is impossible to know from the respondents' answers to the relevant AFP survey questions whether a material change in circumstances, for example, a change in credit quality of the customer, was the cause of the denial of credit or change in credit terms. Moreover, as discussed above, no matter how significant from an objective viewpoint a change in credit terms might appear, it is impossible to know whether a respondent felt it had in any sense been coerced in connection with the change.

Another example of an incorrect impression conveyed by the AFP Survey Report is the finding that "[m]any financial professionals indicate that commercial banks do not always offer . . . credit as a stand-alone product."[10] This finding in no way evidences illegal tying by banks. Credit as a stand-alone product may not meet a bank's internal targeted rate of return, and section 106 does not require banks to offer products or services to customers that do not meet such internal "hurdle rates." The AFP Survey Report fails to recognize this fundamental concept of relationship banking. Furthermore, this finding of the AFP Survey Report is consistent with the fact that it is permissible under section 106 for a bank to explicitly tie credit to traditional bank products.[11]

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[7] 68 Fed. Reg. at 52028.

[8] AFP Survey Report at 6.

[9] Quoting the *Proposed Interpretation*, 68 Fed. Reg. at 52026.

[10] AFP Survey Report at 6.

[11] The AFP Survey Report, referring in large part to the statutory exception for tying arrangements involving traditional bank products, states that "there is a lot of ambiguity as to the products and services that can and cannot be 'tied.'" *Id.* at 4. The existence of such ambiguity would make it impossible to draw the sweeping, definitive conclusions regarding illegal tying by banks that are drawn in the AFP Survey Report. Further, there is no ambiguity regarding the treatment of cash management services as a traditional bank product. The *Proposed Interpretation* contains a detailed list of traditional bank products, including cash management services. 68 Fed. Reg. at 52030. The AFP conducted its survey

A further example of an incorrect impression conveyed by the AFP Survey Report is the finding that "[a] third of large companies indicate that a commercial bank has explicitly told them that they were denied credit or had credit terms changed because they did not award the bank other business."[12] The AFP Survey Report also finds that "[f]ifty-nine percent of respondents from large companies report that a commercial bank implied that they were denied credit or had credit terms changed because the company did not award the bank other business."[13] In the context of relationship banking, which has recently been described as "serving customers on the basis of the profitability of the overall customer relationship,"[14] a bank may explicitly tell a customer that the bank denied credit or changed credit terms because the bank's overall relationship with the customer does not meet the bank's internal profitability targets. This is entirely consistent with permissible relationship banking and is not evidence of illegal tying by the bank. Certainly section 106 does not prevent a bank from communicating such information to customers, and the AFP Survey Report's finding that "[a] third of large companies have been told by a commercial bank that they would have to provide a specific amount of fee income in order to be granted credit"[15] is merely evidence that banks are engaged in permissible relationship banking.

Another key finding of the AFP Survey Report is that "one out of seven large companies (15 percent) report that in the past five years they have been explicitly required by a commercial bank to obtain corporate debt and/or equity underwriting services from an affiliate of the bank in order to obtain a loan from the bank."[16] This key finding of the AFP Survey Report could be evidence of violations of section 106. It, however, is also seriously flawed because the responses to the relevant AFP survey question do not reflect whether the element of coercion was present, which, as discussed above, is a prerequisite for an illegal tying arrangement. Indeed, it is entirely possible that in these limited cases the respondent itself first delivered a "reverse tying" message to the bank, whereby a customer, in taking full advantage of its "financial

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with knowledge of the *Proposed Interpretation*, yet the AFP Survey Report uses the AFP survey result that 44 percent of large companies reported the tying of credit and cash management services, which is permissible, to support its broad conclusions regarding illegal tying by banks. *See* AFP Survey Report at 8-9.

[12] *Id.* at 7-8.

[13] *Id.* at 8.

[14] Quoting speech of Board Governor Susan Schmidt Bies at the Financial Executives International Chicago Chapter Dinner (July 15, 2004), at 6.

[15] AFP Survey Report at 10.

[16] *Id.* at 6.

wallet," informs a bank that it would award other business to the bank only if the bank makes credit available to the customer. In cases where a bank responded to such a reverse tying proposal initiated by the customer, and entered into negotiations with the customer on the basis of that proposal, a respondent to the AFP survey may well believe that the correct answer to this AFP survey question was "yes" even though the customer, and not the bank, had initiated the tie.

It is also possible that this key finding and other findings of the AFP Survey Report merely reflect the fact that certain respondents do not distinguish between lenders that are commercial banks, which are subject to section 106, and lenders that are nonbank affiliates of commercial banks, which are *not* subject to section 106. Even well respected industry publications often refer to a financial institution group by the name of its lead bank. It is well accepted that a nonbank affiliate of a commercial bank (just like an investment bank and its nonbank affiliates) may explicitly require a customer to obtain products or services from the nonbank or its affiliate in order for the customer to obtain credit from the nonbank, assuming that the nonbank does not have market power in the credit market under the general antitrust laws.

It is significant that the questionnaire does not appear to have included a fourteenth question, namely: *Has your company informed a bank that it would award other financial services to the bank only on the condition that the bank provides credit to the company?* It is assumed that this question was not asked since the AFP Survey Report does not include any discussion of "reverse tying" by customers. This question is one of the most important questions that should be asked in a survey focused on and entitled "Linking Corporate Credit to the Awarding of Other Financial Services" since identification of the party that drives the "linking" is one of the most relevant facts to be determined.[17] The AFP Survey Report goes so far as to state, as a purportedly empirically supportable conclusion, that large companies "are more likely to be subject to linking activity, in part because their size and complex credit needs limit the number of commercial banks that are able and willing to serve them."[18] As discussed in this letter, "linking activity" often occurs at the behest of large customers.

A further limitation of the AFP Survey Report is that its findings are based on responses from only 370 respondents. The AFP Survey Report does not

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[17] A very recent study by ClientKnowledge that is based on interviews with 148 corporations in the United States reports that "**corporate customers [are] using all of the tools at their disposal to access [credit].** Indeed, corporations in . . . North America have increased the number of their banking relationships for the first time for a number of years, and clients have signaled to us that they are specifically allocating business in return for credit." *See* ClientKnowledge, *Relationship Banking ClientReport 2003/4* (July 7, 2004), at 2 (emphasis in original); *see also* Reuters, *Offering credit key to banking relationships –study* (July 21, 2004).

[18] AFP Survey Report at 2.

disclose the total number of persons who received the AFP survey questionnaire or the methodology of the AFP survey.[19] The AFP Survey Report focuses in many instances on large companies with annual revenues of greater than $1 billion. The AFP Survey Report does not disclose how many of the 370 respondents represent such large companies, but in the AFP's 2002 credit access survey only 111 respondents (representing 26 percent of all respondents and 3 percent of the persons who received the survey questionnaire) reported annual revenues of greater than $1 billion. There are approximately 2,000 companies in the United States with annual revenues of greater than $1 billion.[20] Assuming that 30 percent of all respondents to the 2004 AFP survey were large companies (as compared with 26 percent in the AFP's 2002 credit access survey), then the total number of respondents who believed that in the past five years they have been subject to such a tying arrangement would be approximately 16 respondents, representing eight-tenths of 1 percent of the total number of large companies in the United States. The AFP's membership consists of approximately 14,000 individual members, representing approximately 5,000 corporations and other organizations. Approximately 14,200 syndicated loan facilities that received league table credit have been entered into over the past five years,[21] and the total number of commercial and industrial loan facilities entered into over this period is even larger. It is clear that the number of respondents in the AFP survey represents only a very small percentage of the relevant universe of credit customers. Based on the small number of respondents to the AFP survey in the context of the over $1 trillion commercial loan market, one should not draw conclusions that illegal tying by banks of loans to other products is a widespread practice.

Commercial banks take the provisions of section 106 very seriously. Commercial banks have policies and procedures that are designed to ensure compliance with section 106 and their bankers are trained not to violate this section. In addition, compliance and internal audit staff monitor commercial banks' compliance with section 106 and review these policies and procedures and the training programs to confirm that they are working effectively. Banks purely and simply are not widely engaged in illegal tying practices. The lack of credible evidence of illegal tying arrangements strongly supports the conclusion that any illegal tying that may occur would represent aberrations and anomalies rather than the norm, as the AFP Survey Report concludes.[22]

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[19] It is noted that the GAO has recognized "several methodological limitations" of the AFP's previous credit access survey in 2003: "In particular, we could not determine the degree to which these survey results represent the broad population of large companies, due to potential biases resulting from sample design and the low level of participation of sampled companies." GAO Report at 15 n.20. These same methodological limitations are present in the 2004 AFP Survey Report.

[20] Source: Standard & Poor's.

[21] Source: Loan Pricing Corporation.

[22] Our position is supported by findings of the Board, the Office of the Comptroller of the Currency (the "OCC"), and the GAO. For example, in its September 2003 "White Paper" the OCC stated: "There is

The market for loans to large companies is the most competitive capital market in the world. If anything, the evidence in this competitive market conclusively shows that it is a borrower's market and not a lender's market. Large and savvy borrowers are playing one financial institution off against another for the best deals in this market. The Antitrust Division of the Department of Justice (the "Antitrust Division") has stated: "We see no evidence that large borrowers such as syndicated loan borrowers need additional assistance beyond the antitrust laws to protect themselves from anti-competitive tying."[23] Today, large companies have more financing options than ever before, with some, for example, choosing to replace their bank debt with capital raised in the bond market and the commercial paper market. The totality of the evidence supports the opposite conclusion than that portrayed by the AFP Survey Report.

The AFP Survey Report emphasizes its finding that 57 percent of respondents from large companies report that as a result of consolidation among large commercial banks, the number of banks that are willing and able to meet their company's credit needs has decreased over the past five years.[24] The AFP Survey Report also states that 44 percent of respondents from large companies report that the number of banks that are willing and able to meet their company's credit needs has stayed the same or increased over the past five years.[25] A comparison of the 2003 Domestic Lead Arranger list with, for example, the 1999 Domestic Lead Arranger list prepared by Loan Pricing Corporation makes clear that there has been no decrease in the number of banks and other financial institutions that provide such credit. These lists also evidence market share volatility and a decrease in concentration, which reflects the dynamic nature of the intense bidding market competition that characterizes this credit market.

Even if it were correct that there has been a decrease in the number of banks that provide such credit, it must be recognized that it is well accepted that (i) notwithstanding the consolidation that has occurred among large commercial banks, no

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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>." Office of the Comptroller of the Currency, International and Economic Affairs Department and Law Department, *Today's Credit Markets, Relationship Banking, and Tying* (Sept. 2003), at 30 (emphasis in original). Just one month later, in October 2003, the GAO reported that it did not find evidence of illegal tying by banks. GAO Report at 4, 15, 39.

[23] Letter to Jennifer J. Johnson, Secretary of the Board, from R. Hewitt Pate, Assistant Attorney General of the Antitrust Division, and J. Robert Kramer II, Director of Operations of the Antitrust Division, dated Nov. 7, 2003, at 8.

24 AFP Survey Report at 12.

[25] *Id.*

bank has market power in the market for loans to large companies and (ii) a tying arrangement can result in anti-competitive practices *only if* the seller has market power in the market for the tying product (the desired product). "Firms that lack [market] power cannot injure competition no matter how hard they try."[26] Accordingly, this expressed concern in the AFP Survey Report could not result in any anti-competitive consequence for large companies.

For all the reasons discussed in this letter, we submit that the AFP survey is materially flawed and should not be accorded serious consideration.

Very truly yours,

Beth L. Climo

cc: Scott Alvarez
Kieran J. Fallon
Mark E. Van Der Weide
Andrew S. Baer
Joyce Hansen
Ivan Hurwitz

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[26] Quoting Judge Frank H. Easterbrook, *The Limits of Antitrust*, 63 Tex. L. Rev. 1, 20-21 (1984). Judge Easterbrook sits on the Seventh Circuit Court of Appeals. *See also Jefferson Parish Hospital No. 2 v. Hyde*, 466 U.S. 2, 25 (majority opinion) ("Only if [buyers] are forced to purchase [seller's] services as a result of the [seller's] market power would the arrangement have anticompetitive consequences."); 10 Phillip E. Areeda *et al.*, *Antitrust Law* ¶ 1734a, at 39 (1996) ("[T]he rationale for requiring proof of power over the tying [desired] product must be that no 'tie-in' can occur or cause any detrimental effect . . . without it."); *id.* at ¶ 1734b5, at 46 ("[P]ower is a precondition that must be satisfied before detriments, if any, can flow from an illegal tie."); *id.* at ¶1734d, at 54 ("[W]ithout power in the first [desired-product] market, no harm to competition in the tied[-product] market can occur.").