Special Notice to Members

SEPTEMBER 2002

SUGGESTED ROUTING

Corporate Finance

Legal & Compliance

Senior Management

REQUEST FOR COMMENT ACTION REQUESTED BY OCTOBER 21, 2002

Prohibition of Certain Bank Tying Arrangements

NASD Advises Members that Participation in Tying Arrangements that Violate Federal Statutes Also Violate Just and Equitable Principles of Trade; Requests Information Concerning Such Practices; **Comment Period Expires October 21, 2002**

KEY TOPICS

Investment Banking

Just and Equitable Principles of Trade

NASD Rule 2110

Discussion

NASD is concerned that the practice of tying commercial credit to investment banking is becoming increasingly widespread. For example, a recent survey of 3,500 corporate financial officers by the Association of Financial Professionals found that 48% believed that "if they did not award other business to short-term lenders, the amount of short-term credit provided would be reduced" and 39% would expect no credit to be offered if they did not award other business to lenders.[1]

Section 1972(1) of the Bank Holding Company Act Amendments of 1970 ("BHCA") provides that a bank shall not extend credit to a borrower on the condition that a borrower obtain some other service from the bank or an affiliate of the bank.[2] Congress enacted the anti-tying provisions of the BHCA "to provide specific statutory assurance that the use of the economic power of the bank will not lead to a lessening of competition or unfair competitive practices."[3] In light of the unique economic role that banks play by virtue of their control over a company's credit, Congress perceived tying transactions involving credit as "inherently anti-competitive, operating to the detriment of banking and non-banking competitors alike; thus the anti-tying provisions were intended to regulate conditional transactions in the extension of credit by bank more stringently than had the Supreme Court under the general antitrust statutes."[4] Accordingly, Congress dispensed with the need to prove the economic power of banks or to prove the anticompeti-

tive effects of tying arrangements under the BHCA.[5] In addition, the statute permits customers or competitors who believe that they have suffered injury to their business or property due to illegal tying to pursue treble damages in a civil suit.

NASD's investigations into bank tying arrangements indicate that tying commercial loans to investment banking services usually arises in the following three commercial banking contexts: (1) bridge loans in which the loan is intended to be repaid out of the proceeds of a bond offering; (2) backup credit facilities that support a company's issuance of commercial paper; and (3) syndicated loans.[6] Access to these types of credit at commercial rates is critical to many companies and may provide a bank with the opportunity to require a company to purchase tied investment banking services, such as investment grade debt underwriting. In addition, illegal tying arrangements may involve structuring commercial credit transactions to support investment banking activities, such as providing federally insured bridge loans to support a merger or acquisition transaction managed by the investment bank.

NASD cautions members that it would violate Rule 2110, which requires members to conduct business in accordance with just and equitable principles of trade, for any member to aid and abet a violation of the BHCA by an affiliated bank.[7] A member would be deemed to have aided and abetted a violation of the BHCA if the member charged a company for investment banking services when it knew or had reason to know that the purchase of those services had been tied to the provision of commercial credit, in violation of the federal banking laws.

NASD also is concerned that tying may occur with respect to other services, such as pension management services. For example, any arrangement that ties the pricing of a company's investment banking services to services the investment bank or its affiliates provide to the company's employee pension plan could violate the company's fiduciary duties under the Employee Retirement and Income Security Act ("ERISA").[8] NASD cautions members that it would violate Rule 2110 for any member to aid and abet a violation of ERISA.

Action Requested

NASD encourages all interested parties to provide information concerning any arrangement in which commercial lending or pension plan services have been tied to investment banking services. NASD encourages commenters to provide specific examples of such arrangements. This information should be provided by October 21, 2002 to:

Corporate Financing Department

NASD

9509 Key West Avenue

Rockville, MD 20850

Or

e-mailed to *nasdrcorpfin@nasdr.com*

Questions/Further Information

Questions concerning this *Notice to Members* may be directed to Joseph E. Price, Director, Corporate Financing Department, at (240) 386-4623.

Endnotes

1 *See also*, Letter from Rep. John D. Dingell, Ranking Member, Committee on Energy and Commerce to Alan Greenspan, Chairman of the Board of Governors of the Federal Reserve System and John D. Hawke, Jr., Comptroller of the Currency, dated July 11, 2002 (tying "has become a central feature of the strategy of a number of large 'universal' banks").

2 The prohibition is subject to certain exemptions for traditional commercial banking services. 12 U.S.C.A. @ 1971 et seq.

3 S. Rep. No. 1084, 91st Cong., 2d Sess. 16, reprinted in 1970 U.S. Code Cong. & Admin. News 5519, 5535.

4 *Dibidale v. American Bank and Trust Co.*, 916 F. 2d 300, 306 (5th Cir. 1990) ("Dibidale"), *quoting* S. Rep. No. 1084, 1970 U.S. Code Cong. & Admin. News 5558 (Letter of Assistant Attorney General Richard McLaren).

5 *Id.*

6 *Cf.*, The Association of the Bar of the City of New York to Ms. Jennifer Johnson, Secretary, Board of Governors of the Federal Reserve System (May 8, 2001).

7 Section 23B of the Federal Reserve Act also prohibits an insured bank from extending credit to a company if the bank would not extend credit but for investment banking services provided to that company by an affiliate. A bank that under prices credit facilities as a loss leader in order to commit a company to purchase the bank's affiliated investment banking services would violate the Federal Reserve Act.

8 H.R. Rep. No. 1280, 93rd Cong., 2d Session 302.