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Death to Credit as Leverage: Using the Bank Anti-Tying Provision to Curb Financial Risk

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DEATH TO CREDIT AS LEVERAGE: USING THE BANK ANTI-TYING PROVISION TO CURB FINANCIAL RISK

FELIX B. CHANG*

Today, the need for nimble financial regulation is paramount. The Dodd-Frank financial reform bill has not prevented further scandals and will not stop banks from selling risky products. Yet one understudied law is a surprisingly versatile device that has the potential to temper financial risk: the Bank Holding Company Act’s Anti-Tying Provision. The Anti-Tying Provision prohibits banks from requiring borrowers to purchase additional products in order to obtain a loan. It applies antitrust principles to bank sales and lending practices. Under antitrust law, a seller cannot condition the availability of one item (the desired product) on the consumer’s purchase of another item (the tied product). Similarly, the Anti-Tying Provision limits when banks can condition the availability of credit on a borrower’s purchase of another product. In the last two decades, those limits have been eroded by numerous exceptions.

This Article recasts the Anti-Tying Provision as a bulwark against financial risk. Specifically, this Article proposes narrowing the exceptions to the Anti-Tying Provision so as to reduce the types of investment products that can be tied to loans. Further, this Article argues that plaintiffs in bank tying actions need only prove the existence of a tying requirement, rather than actual coercion. Bolstered in these two ways, the Anti-Tying Provision can curtail sales of risky financial products to borrowers.

An expanded role for the Anti-Tying Provision draws upon four theoretical underpinnings. First, this approach approximates the separation between commercial and investment banking that was central to the Glass-Steagall Act and is again resurgent with the Volcker Rule. Second, recent developments in antitrust scholarship suggest that credit can be manipulated as leverage and rate evasion. Third, borrower wel-

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fare is the proper framework from which to evaluate tying, so the effect of leveraging credit should be analyzed for its harm to borrowers, not its benefit to banks. Fourth, one lesson from the financial crisis is that antitrust law must be concerned with more than efficiency. By extension, the Anti-Tying Provision should be viewed as serving broad goals such as mitigating financial risk.

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I. INTRODUCTION

A common maxim among bankers in the aftermath of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") is that banks will continue to make money. They will just have to work harder to do so. Passed in response to the global financial crisis of 2008, Dodd-Frank has been a lightning rod for criticism, from both the right and the left. If anything, banks seem to have responded to greater regulation with greater risk-taking. The act may therefore have the perverse effect of spurring another period of financial experimentation. As bank divisions affected by Dodd-Frank find new ways to make money, regulators will need a framework that can check unbridled experimentation with financial products not yet devised.

At this juncture, effective reform of the banking sector may well hinge upon existing laws that have withstood the give-and-take between industry and regulators—in particular, modest yet adaptable laws that have been flanked by less fanfare


than Dodd-Frank. One such law is the anti-tying provision under the Bank Holding Company Act (the "Anti-Tying Provision"), which generally prohibits a bank from requiring that a borrower purchase another product or service in order to obtain a loan, a concept taken from tying restrictions under the Sherman and Clayton acts.\footnote{The Anti-Tying Provision is found at 12 U.S.C. § 1972. It also known as "Section 106," referring to the section it occupies in the Bank Holding Company Act Amendments of 1970.} The Anti-Tying Provision occupies a sleepy corner of banking regulations, having seen little academic coverage in the 42 years since its enactment.\footnote{But see, e.g., Christian A. Johnson, Banking, Antitrust, and Derivatives: Untying the Antitying Restrictions, 49 BUFF. L. REV. 1 (2001) [hereinafter Johnson, Banking, Antitrust, and Derivatives]; Christian A. Johnson, Holding Credit Hostage for Underwriting Ransom: Rethinking Bank Anti-Tying Rules, 64 U. PITT. L. REV. 157 (2002) [hereinafter Johnson, Holding Credit Hostage]; Richard K. Kim, The Federal Reserve's Proposed Interpretation Regarding the Anti-Tying Restrictions of Section 106 of the Bank Holding Company Act Amendments of 1970, 8 N.C. BANKING INST. 1 (2004); Timothy D. Naegele, The Anti-Tying Provision: Its Potential Is Still There, 100 BANKING L.J. 138 (1983); and Timothy D. Naegele, The Bank Holding Company Act's Anti-Tying Provision: 35 Years Later, 122 BANKING L.J. 195 (2005) [hereinafter Naegele, Anti-Tying Provision: 35 Years Later].} To date, this law’s enforcement remains lax despite empirical evidence on not only the prevalence, but also the impact, of aggressive tying practices. Such evidence includes two key studies on bank tying in the United States and Europe.\footnote{Ass'n of Fin. Prof'l's, 2004 Credit Access Survey: Linking Corporate Credit to the Awarding of Other Financial Services 4 (June 2004) [hereinafter AFP Survey]; Centre for European Policy Studies, Tying and Other Potentially Unfair Commercial Practices in the Retail Financial Service Sector, submitted to the European Commission (2009), http://ec.europa.eu/internal_market/consultations/2010/tying_en.htm [hereinafter EU Tying Report]. These studies show that tying is experienced by a significant proportion of borrowers, to the detriment of transparency and consumer choice. For further details, see infra Part II.C.} Recent actions by the British Financial Services Authority against banks that have pushed swaps onto borrowers also shed light into the pervasiveness of tying on both sides of the Atlantic.\footnote{See FSA Finds Banks Guilty of Mis-selling to Small Firms, BBC News (June 29, 2012), http://www.bbc.co.uk/news/business-18640101 [hereinafter FSA Finds Banks Guilty].}

This Article advocates taking a fresh look at the Anti-Tying Provision as one possible tool in the arsenal of financial reform. Under the Anti-Tying Provision, if a borrower wishes to obtain one product, usually credit (in antitrust parlance, \dots}
the "tying" or "desired" product), a bank cannot require the borrower to also purchase another product (the "tied" product) from the bank or its affiliate. The rule does permit the tying of "traditional bank products" such as deposits and trust services, an exception which has been expanded in the last two decades. With a few adjustments—for instance, slowing the growth of the traditional bank products exception—the Anti-Tying Provision could become versatile enough to prevent commercial banks from pushing risky financial products upon borrowers in the future.

Discourse on the Anti-Tying Provision has unfolded on a highly technical level, with little imagination of how a more robust rule might serve the financial sector. The most recent flurry of commentary on the Anti-Tying Provision dates back to 2003, when the Federal Reserve issued a set of tentative interpretations on the law (the "Proposed Interpretation"). In the Proposed Interpretation, the Federal Reserve attempted to clarify when tying practices might meet the Anti-Tying Provision's many exceptions and safe harbors. The agency also suggested that banks could tie loans to certain derivatives,

8. For example, a bank cannot require a borrower to purchase life insurance from an affiliated insurance agency in order to obtain a loan. See infra Part II.A.


10. Thus, a bank can require a borrower to set up a checking account with the bank or use the bank to administer a trust for the borrower to get a loan. See infra Part II.A.


12. The sheer volume of exceptions threatens to swallow the rule, so that the Anti-Tying Provision resembles the proverbial swiss cheese with more holes than cheese. Elsewhere, the characterization as more-holes-than-cheese has often signaled that a doctrine is ripe for re-evaluation. See, e.g., Douglas A. Berman, Conceptualizing Booker, 38 Ariz. St. L.J. 387 (2006) (the Sixth Amendment and sentencing); Richard D. Friedman, Who Said the Crawford Revolution Would Be Easy?, 26 WTR CRIM. JUST. 14 (2012) (the Confrontation Clause and the hearsay rule).
such as interest rate, foreign exchange, and credit default swaps.\textsuperscript{13} Derivatives are financial instruments whose value is based on the value of other assets or variables—for example, the movement of interest rates, the price of stock, or whether a party defaults on a loan.\textsuperscript{14} In hindsight, the Proposed Interpretation’s deference to derivatives has proven to be colossally misguided. The financial crisis was brought on in large part by these products. Derivatives as seemingly innocuous as interest rate swaps compounded exposure to fluctuations in interest rate spreads, wreaking havoc on borrowers in a series of high-profile bankruptcies.\textsuperscript{15} Among the shortcomings of existing literature, this failure—to recognize the fallout from the erosion of the Anti-Tying Provision—looms largest.

This Article proposes using the Anti-Tying Provision to reduce financial risk by limiting the ability of banks to engage in tying. Further, this Article proposes two adjustments to the Anti-Tying Provision, so as to better enable regulators (and also borrowers, who have a private right of action) to challenge bank tying activity.\textsuperscript{16} The first adjustment is for regulators to recalibrate the pace of enlargement of the traditional bank products exception. The lesson from the financial crisis is that introduction of risky financial instruments to the market must be done deliberately rather than haphazardly. The second adjustment—or more precisely, a clarification—is to dispense with any requirement upon borrower-claimants to show that they were coerced into purchasing a tied product. A more suitable alternative would be for claimants to show that purchasing the tied product was required. This would resolve a circuit split in the way courts have interpreted the elements of the Anti-Tying Provision.

\begin{flushleft}
\hspace{8em}

\begin{itemize}
\item 13. See Proposed Interpretation, \emph{supra} note 11, at 52028, 52030.
\item 16. See \textit{infra} Part III.A. These are substantive changes to the law. A subsequent piece will explore procedural changes, such as whistleblower provisions and affidavits from bank officials certifying the absence of tying.
\end{itemize}
\end{flushleft}
This Article breaks new ground in bank anti-tying scholarship by recasting the Anti-Tying Provision as an instrument for the type of meaningful reform envisioned by, but far from being realized in, the embattled Dodd-Frank Act. There is an elegance in the Anti-Tying Provision that may help stave off the next financial crisis. In principle, this set of tying restrictions prevents banks from foisting unwanted products and services upon customers, except under limited circumstances. Narrowing those circumstances can insulate one slice of the economy—borrowers—from the harms of risky tied products. If risky financial products cannot be pushed into the economy by being tied to loans, then if those products tank precipitously in value, fewer entities will be exposed and contagion will be more easily contained. Having weathered four decades of economic cycles and disparate regulatory philosophies, the Anti-Tying Provision is an apt instrument of financial reform; for the decades have illuminated a sensible equilibrium where the rule should rest, balancing risk and innovation.

A fresh look at the Anti-Tying Provision is also timely because of novel turns in the academic literature on antitrust law. The financial crisis has led to intense soul-searching within the antitrust community. Scholars have wrestled with whether the laissez-faire approach of the Chicago School, which has dominated antitrust jurisprudence in recent decades, might have contributed to the deference to markets that led to such spectacular bank collapses. Meanwhile, within the circle of antitrust scholars interested in tying, Einer Elhauge’s 2009 article *Tying, Bundled Discounts, and the Death of the Single Monopoly Profit Theory* has also touched off spirited debate over tying’s anticompetitive effects. Even bank antitrust law has not been immune from the post-2008 introspection, although most of the scrutiny has centered on bank

17. The Chicago School began as a response to the aggressiveness of the Warren Court and the Justice Department’s antitrust enforcement in the 1960s. It was canonized as the leading approach to antitrust during the Reagan Administration. With efficiency as its rallying cry, the Chicago School advocated a lighter touch to enforcement. See Herbert Hovenkamp, Federal Antitrust Policy: The Law of Competition and Its Practice § 2 (4th ed. 2010) at § 2. For more, see infra Part V.

mergers. Only the Anti-Tying Provision, that infusion of anti-trust principles into bank sales and lending practices, seems to have been untouched by the renewal of scholarly interest. Consequently, several controversial positions on bank tying remain in the public domain without reevaluation from a post-crisis perspective.

Part II of this Article traces the history of the Anti-Tying Provision, including the expansion of the traditional bank products exception and the consequences of that expansion.

Part III argues that slowing the pace of enlargement of the traditional bank products exception sensibly cabins financial experimentation, until an innovative product has weathered the economic fluctuations or regulatory deliberation and is accepted as a traditional banking product. This part also recommends that the Anti-Tying Provision be interpreted to require claimants in tying actions demonstrate the requirement of purchasing a tied product, rather than coercion into purchasing a tied product. This part then addresses the potential criticism that borrowers are not a group which requires protection against financial risk, either because borrowers are often large and sophisticated entities or because financial reform designed to benefit borrowers does not touch upon a sufficiently broad cross-section of the economy.

Part IV situates the Anti-Tying Provision within a broader regulatory philosophy—most notably reflected in the Glass-Steagall Act and the Volcker Rule—which separates commercial activity (e.g., deposit-taking) from investment activity. This delineation helps keep volatile financial instruments se-


21. Enacted in 1933, the Glass-Steagall Act sought to separate commercial banking from investment banking. See Melanie L. Fein, Securities Activities of Banks §§ 1.02, 4.01-4.03 (3d ed. 1997). The Volcker Rule, one of the most controversial sections under Dodd-Frank, prohibits federally insured banks and their affiliates from engaging in proprietary trading and owning hedge funds and private equity funds. See 12 U.S.C. § 1851.
questered to investment banking, which tends to be dominated by more sophisticated clients.

Part V draws analogies to general antitrust law to support the recommendations in this Article. This part begins with the anticompetitive effects of bank tying and then concludes with a re-evaluation of the goals of antitrust law. In totality, this part anticipates and addresses the critique that the Anti-Tying Provision was grounded in antitrust principles, so it would be a transgression of Congressional intent to construe the rule as serving any goal beyond fostering competition. As legislative history, subsequent case law, and academic literature indicate, the goals of antitrust law are much more nuanced than a singular focus on competition.22

II. THE EROSION OF BANK TYING RESTRICTIONS

The Anti-Tying Provision prohibits a bank from offering a product or service (usually credit) on the condition that a customer either (i) obtain another product or service (the tied product) from the bank or one of its affiliates or (ii) refrain from obtaining a tied product from the bank’s competitors.23 By way of illustration, suppose that a real estate developer, Bill Borrower ("Borrower"), approaches a bank ("Bank") about the possibility of securing a loan (the desired product) to purchase waterfront property for development. Bank offers


23. Proposed Interpretation, *supra* note 11, at 52027. In application, courts and commentators have generally broken down these two requirements into some combination of the following five elements: specifically, a tying arrangement must (i) involve two separate products or services; (ii) be anticompetitive; (iii) convey a benefit to the bank; (iv) bring damage to the claimant; and (v) be unusual and not subject to an exception. See, e.g., Johnson, *Banking, Antitrust, and Derivatives*, *supra* note 5, at 21 (five elements); Naegele, *Anti-Tying Provision: 35 Years Later*, *supra* note 5, at 202 (three elements); Doe v. Northwest Bank Minn., N.A., 107 F.3d 1297, 1304 (8th Cir. 1997) (four elements); Kenty v. Bank One, 92 F.3d 384, 394 (6th Cir. 1996) (three elements); NCBN Tex. Nat’l Bank v. Johnson, 11 F.3d 1260, 1268 (5th Cir. 1994) (three elements).
Borrower a variable-rate loan at prime rate plus 5 percent (the "Rate").\textsuperscript{24} Under the Anti-Tying Provision, Bank cannot then indicate to Borrower that the loan and the Rate are conditioned upon Borrower's purchase of another product (the tied product)—for example, a life insurance policy (Figure 1).

\begin{tikzpicture}
  \node[draw, rectangle, minimum width=2cm, minimum height=1cm] (loan) at (0,0) {loan};
  \node[draw, rectangle, minimum width=2cm, minimum height=1cm] (life) at (2,0) {life insurance};
  \draw[->] (loan) to (life);
\end{tikzpicture}

\textbf{Desired Product} \hspace{1cm} \textbf{Tied Product}

\textbf{FIGURE 1. EXAMPLE OF A PROHIBITED TIE}

If, however, the tied product falls within the traditional bank products exception, tying is permissible. Trust services, for instance, are considered a traditional bank product. Therefore, Bank may condition the availability of Borrower's loan or the Rate upon Borrower's utilization of Bank's trust services (Figure 2).

\begin{tikzpicture}
  \node[draw, rectangle, minimum width=2cm, minimum height=1cm] (loan) at (0,0) {loan};
  \node[draw, rectangle, minimum width=2cm, minimum height=1cm] (trust) at (2,0) {trust services};
  \draw[->] (loan) to (trust);
\end{tikzpicture}

\textbf{Desired Product} \hspace{1cm} \textbf{Tied Product}

\textbf{FIGURE 2. EXAMPLE OF A PERMITTED TIE}

This Part begins by tracing the history of the exceptions to the Anti-Tying Provision, including, most prominently, the traditional bank products exception. Collectively, these exceptions have weakened bank tying restrictions on several fronts. This Part then explores the consequences of regulators rushing to sanction tying practices. These practices have subjected broad swathes of the economy to various financial instruments, some—such as derivatives and securities lending—sub-

\textsuperscript{24} The prime rate is published in the \textit{The Wall Street Journal} and fluctuates daily.
sequently proven to entail far more risk than originally foreseen.

A. The Expansion of “Traditional Bank Products”

The basis for the traditional bank products exception rests in language from 12 U.S.C. § 1972 providing that a “bank shall not . . . extend credit . . . on the condition or requirement . . . that the customer shall obtain some additional credit, property, or service from such bank other than a loan, discount, deposit, or trust service.”25 The Federal Reserve is authorized to grant additional exceptions by regulation or order.26 Hence, traditional bank products may be defined either by statute—as in the above case of a loan, discount, deposit, or trust service offered by a bank27—or by regulation—as in the extension of the loan, discount, deposit, or trust service exemption to an affiliate of a bank.28 Returning to the earlier illustration of Borrower and Bank, we can imagine Bank informing Borrower that the rate


(1) A bank shall not in any manner extend credit . . . or furnish any service, or fix or vary the consideration for any of the foregoing, on the condition or requirement—

(A) that the customer shall obtain some additional credit, property, or service [the “Additional Service”] from such bank other than a loan, discount, deposit, or trust service;

(B) that the customer shall obtain some [Additional Service] from a bank holding company of such bank, or from any other subsidiary of such bank holding company [collectively, “Bank Affiliates”];

(C) that the customer provide some [Additional Service] to such bank, other than those related to and usually provided in connection with a loan, discount, deposit, or trust service;

(D) that the customer provide some [Additional Service] to a [Bank Affiliate]; or

(E) that the customer shall not obtain some [Additional Service] from a competitor of such bank [or] its [Bank Affiliate], other than a condition or requirement that such bank shall reasonably impose in a credit transaction to assure the soundness of the credit.

26. Proposed Interpretation, supra note 11, at 52024.


of the loan is the prime rate plus five percent only if Borrower uses Bank as the trustee to administer a pool of Borrower’s assets in trust. This would be permitted under the Anti-Tying Provision, since trust services offered by Bank are a statutorily permitted tied product. If Bank’s trust services are run instead by a trust company that happens to be a sister company to Bank, then Bank can also impose the condition of purchasing trust services from the affiliate, since the permitted tie has been extended by regulation to the affiliate.

Over time, this notion of traditional bank products has become the most significant protection for bank tying practices—even though 12 U.S.C. § 1972 does not contain the words “traditional bank product.”32 This exception, narrow in conception, was grounded in the drafters’ intention to convey to the Federal Reserve the ability to enumerate additional exemptions.30 Yet the array of products and services that have made the list of permissible ties reveals the enormous distance that has been traveled from the original language of the Anti-Tying Provision in the short time since its adoption in 1970. In issuing the Proposed Interpretation, the Federal Reserve counted sixteen types of traditional bank products, including bank-issued credit derivatives, loan syndications, asset management services, and securities lending (Figure 3).31 Intense lobbying by the banking industry has focused on classifying problematic tying practices under the rubric of traditional bank products.32 As characterized by attorney Timothy Naegele, who helped write the Anti-Tying Provision, “[t]he exemption for ‘traditional banking practices,’ which should have been very narrow in its effect, has become what is tantamount to the eye of a needle through which ‘herds of camels’ have been

29. The statute merely names “loan, discount, deposit, or trust service” as permissible tied products. See 12 U.S.C. § 1972(1)(A). Yet this language has formed the basis for permitting tied products as traditional bank products. See Proposed Interpretation, supra note 11, at 52025.


31. See Proposed Interpretation, supra note 11, at 52030.

32. See Naegele, Anti-Tying Provision: 35 Years Later, supra note 5, at n.6.
driven. That was not Congress' intent, and it does not serve the public interest."\textsuperscript{33}  

\begin{table}[h!]
\centering
\begin{tabular}{|c|c|}
\hline
Desired Product & Tied Product \\
\hline
(i) extensions of credit; & (i) extensions of credit; \\
(ii) letters of credit; & (ii) letters of credit; \\
(iii) lease transactions; & (iii) lease transactions; \\
(iv) credit derivatives; & (iv) credit derivatives; \\
(v) arranging/syndicating/servicing loans; & (v) arranging/syndicating/servicing loans; \\
(vi) deposit accounts; & (vi) deposit accounts; \\
(vii) safe deposit box services; & (vii) safe deposit box services; \\
(viii) escrow services; & (viii) escrow services; \\
(ix) payment and settlement services; & (ix) payment and settlement services; \\
(x) payroll services; & (x) payroll services; \\
(xi) traveler's check/money order services; & (xi) traveler's check/money order services; \\
(xii) cash management services; & (xii) cash management services; \\
(xiii) guardianship/executor services; & (xiii) guardianship/executor services; \\
(xiv) asset management services; & (xiv) asset management services; \\
(xv) custody/securities lending services; & (xv) custody/securities lending services; \\
(xvi) paying agent/transfer agent services & (xvi) paying agent/transfer agent services \\
\hline
\end{tabular}
\caption{Permitted Tied Products Under the 2003 Proposed Interpretation}\textsuperscript{34}
\end{table}

The classification of derivatives as a permissible tied product is particularly troubling. The enactment of the Anti-Tying Provision predates the burgeoning of derivatives. Yet when the Federal Reserve issued the Proposed Interpretation, the

\textsuperscript{33} Id.
\textsuperscript{34} Proposed Interpretation, \textit{supra} note 11, at 52030.
agency revealed a willingness to permit the tying of these instruments under several novel theories.\textsuperscript{35}

The first theory was that derivatives are a traditional bank product. Embedded in the Proposed Interpretation's list of traditional bank products were "[c]redit derivatives where the bank or affiliate is the seller of credit protection."\textsuperscript{36} Although the authors did not provide examples or further guidance, credit derivatives would likely have included credit default swaps, which enable a swap buyer to make payments in exchange for a swap seller's obligation to pay a third party upon the occurrence of a credit event—for example, default on an underlying loan.\textsuperscript{37} Credit derivatives in general are a relatively new type of derivative,\textsuperscript{38} and credit default swaps in particular are widely thought to be responsible for the financial crisis.\textsuperscript{39}

Another basis for allowing the tying of swaps to credit lay in the caveat to the exclusive dealing restriction under the Anti-Tying Provision, which reads: a "bank shall not . . . extend credit . . . on the condition or requirement . . . that the customer shall not obtain some other credit, property, or service from a competitor of such bank . . . other than a condition or requirement that such bank shall reasonably impose in a credit transaction to assure the soundness of the credit."\textsuperscript{40} Exclusive dealing is the practice by which a seller inhibits customers from obtaining products from its competitors. These arrangements are prohibited by the Anti-Tying Provision, but an exception exists to preserve the ability of banks to protect their lines of credit.\textsuperscript{41} Thus, under the Proposed Interpretation, a bank

\textsuperscript{35} The Proposed Interpretation actually begins the discussion on derivatives from a position of uncertainty. See id. at 52027-28 ("The Board requests comment on how interest rate swaps, foreign exchange swaps, and other derivative products that often are connected with lending transactions should be treated under section 106."). Given this starting point, it is odd that the Federal Reserve then does a pirouette to conclude that these very products might be permissible. See id. at 52030, 52032.

\textsuperscript{36} Id. at 52030.

\textsuperscript{37} See infra Part III.B. See also Norman Menachem Feder, Deconstructing Over-the-Counter Derivatives, 2002 COLUM. BUS. L. REV. 677, 708 (2002).

\textsuperscript{38} Id. at 707.

\textsuperscript{39} See Sharma, supra note 14, at 280. For an illustration of how credit default swaps work, see infra Part II.

\textsuperscript{40} 12 U.S.C. § 1972(1)(E) (2011); Proposed Interpretation, supra note 11, at 52032.

\textsuperscript{41} Proposed Interpretation, supra note 11, at 52032.
could condition the availability of a floating-rate loan on the borrower's purchase of an interest rate swap from the bank or an affiliate. Interest rate swaps simulate the effects of a fixed rate loan by having a swap buyer make fixed payments to a swap seller, who in turn pays the buyer variable rates; until the recent financial crisis, these instruments were considered to be fairly safe. We can only speculate how the Federal Reserve became comfortable with derivatives, despite a spate of derivatives debacles in the 1990s; the Proposed Release is cursory and conclusory as to specific tied products. Yet it appears that the agency moved toward permitting these ties not out of satisfaction that the instruments presented little risk, but out of a willingness to push the boundaries of the "traditional bank products" exception as well as to explore other loopholes within the Anti-Tying Provision.

B. The Risk in Tied Investment Products

This Subpart analyzes the damage wrought by two types of products and services that made the Proposed Interpretation's list of permissible tied products: over-the-counter derivatives and securities lending services.

1. Over-the-Counter Derivatives

The Proposed Interpretation paved the way for the tying of two types of swaps in particular, one relatively novel (credit derivatives) and one rather established (interest rate deriva-
tives), but neither thought to have been capable of creating the chaos seen since 2008. Derivatives are instruments whose value fluctuates on the basis of another set of assets or variables. While derivatives have been around in rudimentary form for hundreds of years, the rapid innovation surrounding credit default and interest rate swaps started in the 1980s. These two instruments are not traded on open markets but are customized between contracting parties. Hence, they are termed “over-the-counter” (“OTC”) derivatives—as opposed to exchange-traded derivatives, which now constitute only a small minority of derivatives. From 1990 until the fourth quarter of 2009, the “notional value” of derivatives—that is, the face value of each contract, used as a basis for calculating payment between the parties—grew from roughly $5 trillion to $212.8 trillion. OTC derivatives dominated trading activity.

The rise of credit derivatives, and in particular credit default swaps (“CDSs”), has been consistent with this backdrop of expanding activity. Used wisely, credit default swaps can be helpful—swap buyers obtain guarantee of payment from swap sellers upon the occurrence certain “credit events,” such as bankruptcy of the swap buyer or default on the underlying contract. Therefore, these instruments function like insurance protections. For example, in purchasing a loan from Bank, Borrower might fear that renovations to the waterfront


47. Sharma, supra note 14, at 283.


50. Id.


52. Sharma, supra note 14, at 287. The definitions of “credit event” are taken from the standard documentation of the International Swaps and Derivatives Association (“ISDA”), a derivatives trade group whose documentation has become the industry standard for most derivatives deals. See PARTNOY, supra note 44.
property end up being more extensive than anticipated. If Borrower has to pay his general contractors more, then the ensuing reduction in cash on hand could trigger default under Borrower’s loan with Bank. Therefore, to “hedge” (or mitigate) that risk, Borrower might purchase a CDS which obliges the swap seller to step into Buyer’s shoes upon an event of default and make payments on the loan to Bank.

Derivatives are also commonly—and pejoratively—called “bets.” Yet the stakes are far higher for contracting parties (often called the “counterparties”) than in an ordinary insurance contract or bet, because counterparties are entitled to calibrate payments several orders of magnitude larger than what default on the underlying contract alone would have entailed. Hence, counterparties as colossal as Lehman Brothers and American International Group (AIG) were quickly brought down by credit default swaps. In the case of Lehman Brothers, the bank had taken out CDSs to mitigate its exposure to the housing market. As that market collapsed, Lehman was obligated under the CDS contracts to post more and more collateral. When it could no longer do so, Lehman Brothers Holdings Inc., the financial holding company for one of the most prestigious and storied investment banks in American history, had to file for bankruptcy.53 As for AIG, the insurance giant had written $1.8 trillion in CDSs guaranteeing payment if certain mortgage-backed securities experienced credit events.54 Instability in the housing market led AIG to write down over $30 billion in losses to its CDS portfolio.55 Fearing the same fate as Lehman Brothers, the Federal Reserve Bank of New York pumped $85 billion into AIG, in the form of a revolving two-year credit facility that operated as a bailout.56

Losses suffered by purchasers of interest rate swaps have been no less catastrophic. These swaps constitute the majority of OTC derivatives, dwarfing even CDSs.57 They can benefit

53. For a summary of the Lehman collapse, see Federal Deposit Insurance Corporation, The Orderly Liquidation of Lehman Brothers Holdings Inc. under the Dodd-Frank Act, 5 FDIC Q. No. 2 (2011).
54. Sharma, supra note 14, at 293.
55. Id.
56. Id.
purchasers by turning variable-rate obligations into ones with synthetic fixed rates. For many years, they were thought to be safe, "plain vanilla" instruments. Even after the financial crisis, some have argued that interest rate swaps were not implicated in the tumult. Yet early defenders of interest rate swaps did not foresee the enormity of market risk—or exposure to market movements—from plummeting interest rates. Buyers seek out interest rate derivatives because they anticipate that the synthetic fixed rate will be less volatile than floating rates, which can ebb and flow unpredictably. The "bet" in the minds of buyers is that the synthetic fixed rate will on balance be less than the average rate from floating rate fluctuations. In effect, buyers wager that interest rates will increase; if this happens, buyers will be "in the money" on the swaps.

However, if interest rates dip below the synthetic fixed rate, buyers will be "out of the money." For instance, Borrower from our illustration might be offered a loan at prime rate plus 5 percent (the "Rate"), at a time when the prime rate is hovering around 3 percent. Borrower might be willing to pay a hefty fee to purchase an interest rate swap that mimics a fixed rate of 8 percent. Under the swap, Borrower would pay the swaps seller 8 percent on the underlying loan while the seller pays Bank (the issuer of the loan) the variable Rate. So long as the Rate is greater than 8 percent, Borrower is in the money because Borrower pays the swaps seller less than what the swaps seller pays Bank.

With the financial crisis, however, banks were suddenly reluctant to lend—credit became scarce, and to induce lending activity, the central bank dropped interest rates to record lows. Interest rate swap contracts unexpectedly "turned toxic" as swap purchasers became sharply out of the money (since interest rates were so far below the synthetic fixed rates). In the

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Feder, supra note 37, at 702-05.


most notable example, in 2002 Jefferson County, the largest county in Alabama, had agreed on the advice of JPMorgan Chase & Co. to refinance $3 billion in public works debt into floating-rate bonds, hedged by more than $5.4 billion in interest rate derivatives. Soon the county would teeter on the brink of bankruptcy, the derivatives salesman would land in prison, and the county official who signed onto the deal would be investigated by the Securities and Exchange Commission.

More recently, the revelation that Barclays had conspired to lower LIBOR has subjected the cartel of U.K. banks that set LIBOR to a slew of class action lawsuits by municipal and pension fund purchasers of interest rate swaps. While the claims garnering the most press have been antitrust claims for conspiracy and rate manipulation, the principle harm suffered by the claimants stemmed from consistent out-of-the-money positions on interest rate swaps as a result of deflated variable interest rates.

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61. Id. See also Bachus, supra note 15, at 759; Whitmire & Walsh, supra note 15.

62. Whitmire & Walsh, supra note 15. There were other reasons why this deal imploded—corruption and graft among them. See Matt Taibbi, Looting Main Street: How the Nation’s Biggest Banks Are Ripping off American Cities with the Same Predatory Deals that Brought Down Greece, ROLLING STONE, Apr. 15, 2010. This is not to suggest, then, that a more robust Anti-Tying Provision will be a panacea against all bad swaps deals.


64. See Jennifer Thompson & Brooke Masters, Banks to Repay SMEs for Mis-sold Swaps, FIN. TIMES, June 29, 2012 (detailing the sale of interest rate swaps as hedging products gone awry once interest rates stayed at historic lows, triggering large cancelation and refinancing penalties).
2. Securities Lending and Ancillary Custody Services

It now appears that other products and services that have made their way into the traditional banking products exception may prove catastrophic as well. Recently, the Securities and Exchange Commission indicated that it would be taking a closer look at securities lending, the process by which an institution holding vast amounts of stock lends out some of that portfolio temporarily, typically to hedge funds that engage in short selling and need securities to back their positions.65 Like OTC derivatives, this was a process that had a long history but only took off in recent decades.66

Prior to the financial crisis, securities lending was seen as an innocuous practice in which mutual funds, pension plans, and other institutional investors were the lenders. Securities borrowers would provide collateral to securities lenders for the loaned portfolio; if the collateral was cash, securities lenders would often make leveraged investments with that cash. These investments experienced significant losses after 2008 with market declines.67

The securities lending services provided by banks to their customers would have facilitated the lending of those custom-


66. See Schapiro, supra note 65.

ers' securities portfolios. Banks are involved in securities lending in two capacities: as lending agents or as custodians. Lending agents hold and reinvest the cash collateral provided by securities borrowers to securities lenders, while custodians hold and move securities portfolios on behalf of their clients. Both services are permissible tied products under the Proposed Interpretation. Lending agents limit their exposure contractually so that the securities lender bears all the market risk for the investment of collateral while the lending agent shares in the upside by splitting profits with the securities lender. Despite these risks and limitations, when tied to bank credit, securities lending poses a temptation for customers to fund borrowing costs by loaning out their securities and investing the cash collateral. This temptation was especially pernicious in the heyday of high returns just before 2008.

3. Implications

The emergence of products whose values are subject to tremendous fluctuation as permissible ties to bank loans reflects a willingness of regulators to stretch the notion of "traditional bank products" far beyond the originally enumerated exceptions of deposits and trust services, which tend to be more stable. With these expansions, the statutory exemption has moved into the realm of investments—notably, investments that subject bank customers to higher degrees of risk. The risk is often hidden in the complexity of the products. As compared to, say, asset management or cash management, where the risks are straightforward, it can be much more difficult to discern from all the technical details that swaps and securities lending expose borrowers to market risk. These products also entail other types of risks, such as credit and counterparty risk.

70. See Proposed Interpretation, supra note 11, at 52030.
72. See infra Part III.B.1.
Even if the utility of OTC derivatives and securities lending is conceded, supporters of an expansive reading of permissible ties must contend with the problem that the enactment of the Anti-Tying Provision predates many of these instruments. Those in the camp of pulling back the bank tying restrictions, therefore, had to stretch the exceptions to make way for novel products. In the case of derivatives, the arguments were tenuous. One commonly invoked argument is that these products protect a bank’s interest in the underlying loan by allowing borrowers to hedge risk. Yet both the definition and practice of “hedging” are blurry. While that term may implicate risk mitigation, the real motive of counterparties entering into swaps is that each has a bet on the position of the underlying obligation—whether, for instance, interest rates will go up or go down. Characterization of OTC derivatives as “useful hedging arrangement[s],” therefore, is perhaps too charitable to banks.

Nonetheless, in the flurry of comment letters which followed the Proposed Interpretation, the banking and finance industry urged the Federal Reserve to adopt ever more permissive stances. Comment letters called for a blanket exemption for all derivatives as traditional bank products—or at least a finding that the combination of a loan and a derivative is a single product, rather than two separate products.

C. The Prevalence of Tying

Until recently, the scant empirical research done on bank tying seemed to split on the prevalence of the practice. Two studies undertaken by the federal government concluded that

73. Johnson, Banking, Antitrust, and Derivatives, supra note 5, at 3.
75. Johnson, Banking, Antitrust, and Derivatives, supra note 5, at 36.
tying by banks was rare.\footnote{77} On the other hand, the Association of Financial Professionals ("AFP") has consistently reported intense pressure on borrowers to direct additional business to banks and their affiliates, as well as the adverse consequences that flowed when such business was not awarded.\footnote{78} Surveys conducted by the AFP report directly challenge the conclusions of the Office of the Comptroller of the Currency (OCC) and the U.S. General Accounting Office (GAO).\footnote{79} The AFP’s comprehensive surveys, which break down tied products into categories, are difficult to assail.\footnote{80} By contrast, the OCC and GAO reports rely heavily upon bank examination results and interviews with banks, a bank-oriented perspective that does little to factor in the input of borrowers. Bank officials are savvy enough to negotiate loan conditions orally and then memorialize the terms in documentation that either does not mention tying conditions or includes certification from borrowers that they were not forced into purchasing tied products.\footnote{81} Bank policies themselves are drafted with a view to passing regulatory exams; they do not shed much light on actual lending practice.

Perhaps the most thorough examination of bank tying practices ever conducted has come out of Europe, where a similarly robust antitrust regime has created prominent caselaw and reams of scholarship on transatlantic comparisons.


\footnote{78} AFP SURVEY, supra note 6. For further details, see infra Part III.B.1.

\footnote{79} See GAO STUDY, supra note 77, at 5. The GAO was renamed the Government Accountability Office in 2004.

\footnote{80} The AFP survey does track several types of investment banking tied products. Unfortunately, it does not single out derivatives. But see GAO STUDY, supra note 77, at 15 n. 20 (questioning the AFP Survey’s methodology).

\footnote{81} See Naegele, Anti-Tying Provision: 35 Years Later, supra note 5, at 209; GAO STUDY, supra note 77, at 15.
in competition policy. At the end of 2009, the European Commission released a 416-page report on tying practices of European banks (the "EU Tying Report"), which corroborated high occurrences of tying across Europe. The EU Tying Report was the culmination of a two-year investigation on the retail financial services sector (generally covering consumers and small businesses), followed by another year focusing purely on tying, cross-selling, and conditional sales. According to the report, tying can be found in one-third of the instances of cross-selling, the practice of soliciting consumers of one product to purchase additional products. In the United States, as in Europe, banks have stepped up cross-selling efforts to make up for lost profits from more heavily regulated products.

The EU Tying Report's survey respondents estimated that 60 percent of financial institutions engage in tying, cross-selling, and bundling and that 80 percent of all consumers are affected. Tying is not always harmful, as the study's authors note. Therefore, the authors examined the practice from the lens of anticompetitive effects, propensity for unfairness, and

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82. See, e.g., MICROSOFT ON TRIAL: LEGAL AND ECONOMIC ANALYSIS OF A TRANSATLANTIC ANTITRUST CASE (Luca Rubini, ed., 2010).


84. See EU TYING REPORT, supra note 6, at 12, 14-15. The EU Tying Report's definition of cross-selling encompasses tying and bundling, and its definition of tying blurs into bundling. See id. at 13 ("Tying occurs when two or more products are sold together in a package and at least one of these products is not sold separately"). In the U.S., the narrower definition of tying makes for clearer lines of demarcation.

85. Id. at 16.

86. See David Henry & Dakin Campbell, BANKS TURN TO CROSS-SELLING TO BOOST PROFIT, BLOOMBERG NEWS, reprinted in SAN FRANCISCO CHRONICLE, June 23, 2010, http://www.sfgate.com/business/article/Banks-turn-to-cross-selling-to-boost-profit-3260614.php ("Wells Fargo and Bank of America Corp. are pushing their customers to buy more brokerage, savings and banking services from them as the weak economy and new regulations make it harder to earn money from loans and investment banking.").

87. EU TYING REPORT, supra note 6, at 17. The survey respondents were comprised mostly of regulators and associations of financial service providers (75 percent of respondents) and a smaller proportion of financial institutions (25 percent). Id. at 15.
the unique qualities of the retail segment.\textsuperscript{88} The study concludes that tying can reduce customer mobility and price transparency, increase switching costs, and adversely affect consumer confidence.\textsuperscript{89} The asymmetry of sophistication between consumers and financial institutions features prominently in the EU Tying Study's analysis,\textsuperscript{90} leading to the conclusion that many desired products, when tied to something else, can create unfairness for bank customers.\textsuperscript{91} In an effort to quantify the impact of tying, the authors ran a simulation on the effect of tying which demonstrated that without the scrutinized practices, 572 million contracts in the 27 EU countries would have been moved away from the current financial institutions.\textsuperscript{92}

The damaging findings of the EU Tying Study might be mitigated on two grounds. First, Europe is Europe. Antitrust laws there do not always map neatly onto the American antitrust regime.\textsuperscript{93} Bank tying analysis in Europe is further distinguishable in that tying seems to encompass more types of sales practices in Europe than would fall under the narrow, technical strictures of the Anti-Tying Provision.\textsuperscript{94} Second, the EU Tying Study focuses on less sophisticated customers, whose needs do not merit the tying of a broad menu of products.\textsuperscript{95}

\begin{itemize}
\item \textsuperscript{88} Id. at 17-20.
\item \textsuperscript{89} Id. at 21. The efficiencies generated by tying, including lower prices, are factored into this analysis. Id. at 18, 36.
\item \textsuperscript{90} Id. at 18.
\item \textsuperscript{91} When mortgages are the desired product (ominously called "gateway products" in the study), 90 percent of cross-selling practices are found to be unfair, with the most unfair combinations involving investment accounts, bank deposits, and insurance. Id. at 22. When consumer loans are the desired product, 90.5 percent of cross-selling practices are found to be unfair. Id. at 23.
\item \textsuperscript{92} Id. at 24.
\item \textsuperscript{94} On the blurry demarcations separating tying, cross-selling, and bundling in the EU, see EU Tying Report, supra note 6, at 13-14. European tying analysis is also complicated by the overlay of national laws and European regulations such as Article 82 and the Unfair Commercial Practices Directive.
\item \textsuperscript{95} This is not to say, of course, that tying does not occur for unsophisticated borrowers. Cf. FSA Finds Banks Guilty, supra note 7.
\end{itemize}
more sophisticated—and therefore risky—tied products can be predicted to appear is with large corporate borrowers.

In fact, research indicates that tying is more likely to occur for larger rather than smaller borrowers, especially where the desired product is loan syndication. The magnitude of credit involved in syndications is so large that only a small pool of banks can serve as the lead arrangers. It is slightly counterintuitive, but credit is more powerful as leverage with large and sophisticated borrowers than with retail consumers.

It would seem that the consumers and small businesses, which the EU Tying Study is most concerned about tend not to be targets for cross-selling of swaps and securities lending. These customers would not own the diversified securities portfolios to lend to hedge funds for short selling; nor would they be likely to take out variable-rate loans at figures high enough to justify hedging. We do know, however, that banks are beginning to converge upon less sophisticated clientele as competition increases—and tying is the vehicle with which to do so.

On the subject of aggressively pushing tied products upon credit customers, the research on derivatives is most robust. Derivatives trading generates such large revenues that both large and small banks have crowded into the market. In the last decade, as this market became more competitive, banks began to do OTC derivatives deals “with not only the largest and most sophisticated financial institutions, but also with their smaller and less creditworthy borrowers.” When the LIBOR scandal broke in June 2012, it was revealed that potentially tens of thousands of interest rate swaps pegged to LIBOR had been bundled with loans and sold to small- and medium-sized businesses that had not understood nor been informed of the risks. Borrowers were a natural pool to be tapped, since banks have several times more borrowers as

96. See AFP Survey, supra note 6; infra Part III.B.1.
97. Johnson, Banking, Antitrust, and Derivatives, supra note 5, at 15-16.
98. Id. at 15. For fourth-quarter 2011, commercial banks reported derivatives trading revenues of $2.5 billion. OCC’s Fourth Quarter 2011 Report, supra note 57.
99. Johnson, Banking, Antitrust, and Derivatives, supra note 5, at 15-16.
100. Lindsay Fortado & Ben Moshinsky, Barclays, BBS Will Compensate Clients Mis-Sold Derivatives, BLOOMBERG NEWS, reprinted in SAN FRANCISCO CHRONICLE, June 29, 2012
101. See Thompson & Masters, supra note 64.
credit clients than as derivatives counterparties.\textsuperscript{102} In a 2001 study, Christian Johnson noted that out of 200 different multi-
lender loan transactions, more than 180 had loan documentation that featured integrated provisions relating to borrowers' derivatives activities, and 62 contained covenants requiring borrowers to enter into OTC derivatives.\textsuperscript{103}

III.
USING THE ANTI-TYING PROVISION TO SEQUESTER RISK

Given the risks associated with the backpedaling on anti-
tyng protections by the Federal Reserve since the 1990s, this Article advocates taking a different course by strengthening the Anti-Tying Provision and using it as a buffer against financial risk. This Part begins by exploring the contours of what that policy would look like.

This Part then responds to potential criticisms that borrowers do not need the Anti-Tying Provision's protections and that the law is an inappropriate means to curtail financial risk.

A. Modifications to the Current Approach

Two modifications to the Anti-Tying Provision can help keep risky financial products from penetrating broad swathes of the economy. The first is a slower, more deliberate approach to the expansion of "traditional bank products," which subjects products to an overall assessment of risk. The second is to dispense with a showing of coercion in tying claims.

1. Slowing the Expansion of "Traditional Bank Products"

This Article urges the Federal Reserve to consider the full panoply of risks when it evaluates "new" traditional bank products and illustrate publicly how the agency has accounted for those risks. Going forward, thorough assessments of risk would likely mean that the traditional bank products list will be expanded more slowly. Traditional bank products are defined by either statute or regulation;\textsuperscript{104} yet, because the statutory language of the Anti-Tying Provision is so specific, most traditional products have been enumerated by the regulation or

\textsuperscript{102} Johnson, Banking, Antitrust, and Derivatives, supra note 5, at 16.
\textsuperscript{103} See id. at 16, 18.
\textsuperscript{104} Proposed Interpretation, supra note 11, at 52030.
order of the Federal Reserve. As the agency considers future exceptions, it should incorporate the more nuanced understanding of risk gained by industry and regulators in recent years.

A slower pace to the expansion of traditional bank products is especially critical for products with a significant investment component. The appearance of derivatives, securities lending, and asset management on the list of defined traditional bank products in 2003 reveals the Federal Reserve’s inclination to allow commercial banks to move into the investment space via tying. Investment products entail more risk than most of the other products on the Proposed Interpretation list. Derivatives and securities lending present particular challenges to borrowers, as the complexity of these instruments may obscure their risks. While it is true that some tied products on the list have a small investment component—for example, trust services—those products are more easily understood by borrowers. Further, the providers of those services are often bound by fiduciary duty to the client, a separate layer of accountability that places the client’s interests above anyone else’s.

The Federal Reserve’s analysis should not be limited to market risk. While market risk might be especially salient for asset management and securities lending, some products feature other types of risk more prominently. For example, derivatives implicate credit risk (the risk that a counterparty will fail to honor its contractual obligations), liquidity risk (the risk that a party cannot transact without extraordinary loss due to


107. See supra Part II.B.3.

108. With trust services, fiduciaries are compelled to diversify investments so as to mitigate risk from market fluctuations. For more, see infra Part III.B.3.

109. Feder, supra note 37, at 689, 722. Credit risk can be broken down into counterparty risk (the risk of insolvency of a counterparty) and settle-
lack of resources or prospects), and operational risk (the risk that a party’s internal systems will fail to measure, monitor, or control that party’s exposure to risk). Finally, there is systemic risk. Systemic risk has been defined as “the risk that the whole financial system will collapse because of the initial failure of just one or a few players” and “[t]he risk that a default by one market participant will have repercussions on other participants due to the interlocking nature of financial markets.” The role of derivatives in the financial crisis reveals how quickly these instruments can threaten the stability of the global financial system.

These risks vary on a product-by-product basis and may exist in different proportions in different products. Interest rate swaps, for instance, may implicate market risk to a greater extent because these instruments can create so much damage with wild interest rate fluctuations or consistent out-of-the-money positions. In contrast, credit derivatives may implicate credit and systemic risks more. Whatever combination these risks exist in, all of them should be considered by the Federal Reserve, and the agency should indicate in future releases, exemptive orders, and interpretations how it has evaluated these risks. In this way, the agency will at least provide some assurance risk (the risk that a counterparty will fail to reciprocate after one party has discharged its obligations). Id. at 722-25.

110. Id. at 725. Liquidity risk, too, can be broken down into two types: funding liquidity risk (the risk that a party cannot meet payment obligations due to cash shortage) and market liquidity risk (the risk that a party cannot terminate a transaction prior to maturity). Id. at 726-27.

111. Id. at 727.

112. Id. at 729.

113. Steven L. Schwarcz, Systemic Risk, 97 GEO. L.J. 193, 197 (2008) (citing CFTC Glossary, U.S. COMMODITY FUTURES TRADING COMM’N, CFTC GLOSSARY, http://www.cftc.gov/educationcenter/glossary/glossary_s.html). An elegant working definition is “the risk that (i) an economic shock such as market or institutional failure triggers (through a panic or otherwise) either (X) the failure of a chain of markets or institutions or (Y) a chain of significant losses to financial institutions, (ii) resulting in increases in the cost of capital or decreases in its availability, often evidenced by substantial financial-market price volatility.” Id. at 204.

114. Dodd-Frank’s suggestion to centralize clearing in a handful of counterparties, however, may actually increase systemic risk. See Kristin J. Johnson, Clearinghouse Governance: Moving Beyond Cosmetic Reform, 77 BROOK. L. REV. 681 (2012).
ance that it has mapped out all the different effects of "new" traditional bank products upon borrowers.

Finally, the application of a risk-based approach to tying restrictions should spell an end to the tying of derivatives and securities lending services to loans. To date, the Federal Reserve has not issued final interpretations to follow the 2003 Proposed Interpretation. If the agency ever follows up with final interpretations, then derivatives and securities lending services should be removed from the list of traditional bank products. Otherwise, the Federal Reserve should issue an order clarifying that these products are not to be tied to loans or other financial products. This change would correct a position that, in retrospect, injects far too many dimensions of risk into an otherwise straightforward purchase of credit.

2. Clarifying the Requirement of Coercion

One longstanding debate surrounding the Anti-Tying Provision has been whether the law requires a showing of actual coercion by a bank upon its customer to purchase the tied product. Taking a bank-friendly stance, the Proposed Interpretation asserts that a tie must be imposed or forced upon the customer to violate the Anti-Tying Provision.\textsuperscript{115} The Federal Reserve arrived at this conclusion by examining legislative history and by analogy to the general tying prohibitions, which do require coercive imposition.\textsuperscript{116} The contrary position, that coercion is not a necessary element, is the better approach—it finds support in the policy underlying the rule and recent case law. This is also the better position if we are to adopt the Anti-Tying Provision as a proactive check on risky financial products.

Legislative history on the requirement of coercion is mixed. On one hand, the Conference Report, which explained the differences between the House and Senate versions of the bill adopting the Anti-Tying Provision, seemed to

\textsuperscript{115} Proposed Interpretation, supra note 11, at 52028.

view both coercive and voluntary ties as contrary to the Anti-Tying Provision.\textsuperscript{117} The report described ties as resulting either from “actual coercion by a seller or from a customer’s realization that he stands a better chance of securing a scarce and important commodity (such as credit) by ‘volunteering’ to accept other products or services.”\textsuperscript{118} Shortly after that observation, however, the report describes the Anti-Tying Provision as “largely prevent[ing] coercive tie-ins,”\textsuperscript{119} a line that was not lost on the Federal Reserve.\textsuperscript{120} The agency cited this and other pieces of legislative history that strongly suggested that the law was meant to protect borrowers from coercive rather than voluntary ties.\textsuperscript{121}

In concluding the above discussion, the Conference Report does not endorse any staunch view on voluntary versus coercive tying, other than the Federal Reserve’s case-by-case determination on the appropriateness of regulation.\textsuperscript{122} Therefore, it would be a stretch to cite the Conference Report as unequivocal support for either stance.\textsuperscript{123} Nevertheless, the

\begin{itemize}
\item \textsuperscript{117} Naegele, too, notes that a requirement of coercion is inappropriate. See Naegele, \textit{Anti-Tying Provision: 35 Years Later}, supra note 5, at 204 (“Any requirement of coercion is inconsistent with and more stringent than what Congress intended; voluntary as well as coercive ties violate the anti-tying provision.”).
\item \textsuperscript{118} \textit{Conference Report}, \textit{supra} note 116, at 5569.
\item \textsuperscript{119} Id. (emphasis added).
\item \textsuperscript{120} See Proposed Interpretation, \textit{supra} note 11, at 52029 n.34.
\item \textsuperscript{121} See \textit{id}. (citing \textit{Conference Report}, \textit{supra} note 116, at 5569; 116 Cong. Rec. S20647 (daily ed. Dec. 18, 1970) (violation of section 106 occurs "where the totality of the circumstances indicates that the customer has not voluntarily entered into the transaction, but rather has been induced into doing so through coercion") (statement of Sen. Brooke); 116 Cong. Rec. S15709 (daily ed. Sept. 16, 1970)).
\item \textsuperscript{122} See \textit{Conference Report}, \textit{supra} note 116, at 5569, which reads, in part: But the dangers of ‘voluntary’ tie-ins and reciprocity are basically structural and must be dealt with by the Board in determining the competitive effects of bank holding company expansion into fields closely related to banking . . . These will be difficult questions, for assurances of good faith and the intention not to engage in tie-ins and reciprocity by the applicant bank holding companies will largely be irrelevant to the just as serious dangers of ‘voluntary’ tie-ins and reciprocity. The Board, must, in any case, consider these problems in carrying out its responsibilities under the Act.
\item \textsuperscript{123} Cf. Proposed Interpretation, \textit{supra} note 11, at 52029 n.35 (citing \textit{Conference Report}, \textit{supra} note 116, at 5569 for the proposition that “[a]lthough the statute’s legislative history characterizes this type of volun-
Proposed Interpretation pointed to legislative history in its assertion that to run afoul of the Anti-Tying Provision, a bank must force or coerce its customer to obtain the tied product.124

This debate has also played out in the courts, most prominently between the Fifth Circuit in the 1990 case Dibidale of Louisiana, Inc. v. American Bank & Trust Company125 and the Eleventh Circuit in the 1993 case Integon Life Insurance Corp. v. Browning.126 In Dibidale, the majority opinion noted that the Anti-Tying Provision provides no clear guidance on whether the statutory phrase “condition or requirement” implicitly means coercion.127 However, the majority goes on to say that analogy to general tying prohibitions under the Sherman and Clayton acts is imprecise because, among other reasons, “the unique nature of the banking industry renders it more important to prohibit conditional transactions in that context than in other less sensitive sectors of the economy.”128 Congress recognized that transactions involving credit were inherently anticompetitive, since banks dominate control over credit, so Congress chose to impose more stringent anti-tying regulations under the Bank Holding Company Act than under the Sherman and Clayton acts.129 Hence, the majority concluded that restricting the Anti-Tying Provision to tying arrangements where a borrower “is literally forced to purchase or provide a tied product . . . would vitiate that section’s intended role” since Congress recognized that “a tying arrangement may squelch competition whether coercive or not.”130

124. See id. at n.35 (“After carefully reviewing the language, legislative history and purposes of the statute, the Board believes the better interpretation of section 106 is that a violation may exist only if a bank forces or coerces a customer to obtain (or provide) the tied product as a condition to obtaining the customer’s desired product.”).
125. 916 F.2d 300, 304-07 (5th Cir. 1990).
126. 989 F.2d 1143, 1149, 1149-52 (11th Cir. 1993).
127. Dibidale, 916 F.2d at 305.
128. Id.
129. See id. at 305-06.
130. Id. at 306 (citing, not surprisingly, the Conference Report, supra note 116, at 5569). The majority opinion in Dibidale was followed by a dissent that read the language of “condition or requirement” in the statute to mean something essential to the loan, rather than voluntary actions undertaken by
Three years after *Dibidale*, the Eleventh Circuit reached the opposite conclusion in *Integon Life Insurance Corp*. In that case, the court considered an action under the Home Owners’ Loan Act, which regulates federal savings and loans associations (also known as “thrifts”). This act had adopted anti-tying language nearly identical to the Anti-Tying Provision. In its attempt to elucidate the meaning of the operative phrase “an association shall not in any manner extend credit . . . on the condition or requirement,” the court turned to general tying cases. In those contexts, general tying prohibitions required a showing that the purchaser was forced to buy the tied product. Consequently, the Eleventh Circuit concluded, to establish a tying violation under the Home Owners’ Loan Act, a claimant “must prove that the thrift forced or coerced the plaintiff into purchasing the tied product.” This, the court realized, was in direct conflict with the Fifth Circuit in *Dibidale*.

The Federal Reserve has acknowledged *Dibidale* but sided instead with the approach of *Integon*. Days after the promulgation of the Proposed Interpretation, however, the Sixth Circuit decided *Highland Capital, Inc. v. Franklin National Bank*, which exacerbated the circuit split by opting for a middle road between actual evidence and presumption of coercion. The court also echoed the Fifth Circuit’s sense that an emphasis on coercion creates a requirement not contained in the statute.

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133. Those cases involved the claims of a ticket-selling service against a promoter and computerized ticket seller, *Tic-X-Press, Inc. v. Omni Promotions Co. of Ga.*, 815 F.2d 1407 (11th Cir. 1987), a paper distributor for medical electronic equipment against a paper and electronics manufacturer, *T. Harris Young & Assoc., Inc. v. Marquette Electronics, Inc.*, 931 F.2d 816 (11th Cir. 1991), and a supplier of automobile air conditioners against *Volkswagen, Heatransfer Corp. v. Volkswagenwerk, A.G.*, 553 F.2d 964 (5th Cir. 1977).
134. *Integon*, 989 F.2d at 1151.
135. *Id.* at 1151 n.20.
136. See Proposed Interpretation, *supra* note 11, at n.36.
137. See 350 F.3d 558, 567 (6th Cir. 2003).
138. See *id.*
In *Highland Capital*, the plaintiff pointed to circumstantial evidence that fell short of establishing coercion by the lender.\(^{139}\) In weighing the contradictory approaches under *Dibidale* and *Integon*, the court concluded that violation of the Anti-Tying Provision is established by "proof that a bank conveyed an intention to withhold credit unless the borrower fulfilled a 'pre-requisite' of purchasing or furnishing some other product or service."\(^{140}\) A borrower may well assent to a tying condition without force or involuntary submission; essential to a tying claim, however, is that the tied product is a "condition that must be fulfilled before the bank will agree to extend credit."\(^{141}\)

While the Sixth Circuit in *Highland Capital* declined to adopt the majority view in *Dibidale*, it nevertheless believed that a requirement of coercion is beyond the statute.\(^{142}\) This approach is notable not only in signaling that the Fifth Circuit was no longer an outlier in its willingness to presume rather than require evidence of actual coercion, but also in reaching a conclusion quite different from that of *Integon* and the Federal Reserve. Coincidentally, *Highland Capital* was argued less than two weeks after the Proposed Interpretation was published and decided nearly three months afterward.\(^{143}\)

A few other sources on the Anti-Tying Provision do not include coercion as an element that must be proven by the claimant.\(^{144}\) Some believe coercion should be proven, while others do not, but authority is simply too split for the issue to be considered settled.

As a matter of policy, a showing of coercion should not be required upon claimants. The primary concern animating the Anti-Tying Provision was that the complete dominance by banks over one sector of the economy—credit—justifies a more extreme rule to prevent their leverage of that domi-

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139. See *id.* at 566.
140. *Id.* at 567.
141. *Id.* (emphasis added).
142. *Id.*
143. The opinion does not mention the Proposed Interpretation, *supra* note 11.
144. See, e.g., Naegele, *Anti-Tying Provision: 35 Years Later, supra* note 5; 4A *FEDERAL PROCEDURE, LAWYERS EDITION § 8:17* (2012) ("A plaintiff need not make any showing of coercion and need not establish the market share that a defendant possesses to establish unlawful tying.") (citing S&N Equip. Co. v. Casa Grande Cotton Fin. Co., 97 F.3d 337, 346 n.18 (9th Cir. 1996)).
nance to foist products and services upon consumers. Hence, several prongs critical to tying inquiries under the Sherman and Clayton acts were read out of tying inquiries under the Bank Holding Company Act—specifically, that the seller has sufficient power in the tying market, that the tie has anticompetitive effects, and that the tie affects a substantial amount of interstate commerce.\textsuperscript{145} Coercion should also be excluded. The market power of banks over credit was presumed by the drafters of the Anti-Tying Provision. The result of that presumption should be that coercion is inherent in bank dominance over credit and, as such, should not be a burden thrust upon the claimant to prove. So long as a claimant can show the \textit{requirement} to purchase a tied product, the coercion element should be deemed satisfied.

Not requiring claimants to show coercion helps tying claims go forward. Due to oral negotiations on lending, evidence of tying is difficult to obtain.\textsuperscript{146} When regulators and borrowers must prove coercion, their evidentiary hurdles are heightened even more. If the current circuit split is resolved in favor of \textit{Dibidale} or even \textit{Highland Capital}, it would help regulators and borrowers deter problematic tying.

B. Borrowers as Proxies for Consumers

The above recommendations do not protect all sectors of the economy from financial risk, just customers and potential customers of commercial banks. The merit of this framework, therefore, rests upon the assumption that protection of commercial borrowers furthers the interests of the economy as a whole.

One inevitable criticism is that commercial borrowers are often as sophisticated as investment banking customers and do not need to be treated with regulatory paternalism. Another question is whether borrowers comprise a large enough cross-section of consumers to make stronger tying restrictions meaningful. Finally, skeptics might charge that the Anti-Tying Provision should not function as a constraint on financial risk because individual tied products are already regulated directly by

\textsuperscript{145} See Proposed Interpretation, \textit{supra} note 11, at 52027; \textit{Senate Report}, \textit{supra} note 30, at 5558, 5547.

\textsuperscript{146} See Naegle, \textit{Anti-Tying Provision: 35 Years Later}, \textit{supra} note 5, at 209-10.
existing law. This section addresses those potential criticisms in turn.

1. **Conflating Borrowers with Vulnerability?**

The use of a stronger Anti-Tying Provision to preempt wide-scale introduction of risky financial products may invite charges of conflating borrowers with vulnerability. Admittedly, borrowers can be large and sophisticated entities. Syndicated loan deals, for example, where numerous banks pool together to lend to a large debtor, can reach hundreds of millions of dollars—as much money as raised by investment banks in the issuance of publicly traded securities. On this basis, banks have argued that there should be a sophisticated entity exemption to the Anti-Tying Provision since, as the argument goes, large corporate borrowers cannot possibly be coerced into purchasing tied products.

Yet the sophistication-of-borrowers argument suffers from its own empirical fallacy. Because the size and complexity of syndications limit the number of banks able to lend, those banks that do provide syndication services often impose tying conditions. In the face of tightening credit markets and a dwindling pool of lead banks on syndication deals, even large corporate borrowers find that they have little choice but to acquiesce to tying conditions.

In 2004, the Association of Financial Professionals conducted a survey of 370 financial executives from a diverse group of companies which had recently sought out loans (the

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147. See Johnson, *Holding Credit Hostage*, supra note 5, at 174-75.


149. See AFP SURVEY, supra note 6, at 6; Johnson, *Holding Credit Hostage*, supra note 5, at 175, 178.

150. See AFP SURVEY, supra note 6 (reporting that large companies are more likely to be subject to tying activity, in part because of their size and complexity).
"AFP Survey"). The AFP Survey found that nearly two-thirds of respondents from large companies had been denied credit or experienced changes in credit terms after their company did not give their banks additional business. The survey corroborated the prevalence of tying—only 29 percent of all respondents indicated that banks "rarely" or "never" offered credit as a stand-alone product. The responses also demonstrated that large borrowers were particularly vulnerable to tying. Sixty-three percent of respondents from companies with annual revenues greater than $1 billion indicated that a commercial bank had denied them credit or changed credit terms because the company did not award additional business to the bank. That additional business often consisted of investment banking services, such as underwriting and strategic advising. Indeed, 53 percent of all companies reported having been denied credit or having credit terms changed after declining to give investment banking business to a commercial bank. Those banks were often unambiguous in the reasons for denial: 29 percent of all respondents—and one-third of respondents from large companies—indicated that they had been explicitly told by bank officials that the denial or change of credit terms came because the borrowers did not funnel other business to the banks.

Counterintuitive as it may seem, banks appear to have more leverage with larger borrowers. Contrary arguments have been made previously by Bank of America, as part of efforts to create a safe harbor that would hold that large borrowers can never be forced into accepting unwanted products, and therefore tying to large clients should be per se legal. Those arguments are undermined by studies that suggest that the pool of banks that can serve as lead arrangers in syndicated loans is

151. An earlier survey conducted in 2002 uncovered similar concerns; though the 2004 survey was more thorough on the subject of tying. See ASSN OF FIN. PROF'LS AND GEORGETOWN UNIV. CAPITAL MKTS. RESEARCH CTR., THE IMPACT OF FINANCIAL INDUSTRY CONSOLIDATION ON ACCESS TO SHORT-TERM CREDIT (Jan. 2002) (on file with author).
152. AFP SURVEY, supra note 6, at 6.
153. Id.
154. Id.
155. Id. at 7-8.
156. See Letter from Paul Polking to Jennifer Johnson, supra note 148; Letter from John Huffstutler to Scott Alvarez, supra note 148.
very small. In fact, one of the letters from Bank of America to the Federal Reserve in 2005 stated that "[f]or a credit facility of $10 billion or more, there are at least five lenders that could effectively lead arrange such a deal." It would have been more appropriate to say that there were only five such lenders—a number that has only decreased with the bank failures of the financial crisis.

This Article's conception of the Anti-Tying Provision as a buffer against risk also pits large borrowers against large banks in another way. Because exotic financial instruments tend to be utilized by more sophisticated consumers of credit, the Anti-Tying Provision will be at its most effective when banks are sued for tying complex products to the credit deals of the largest borrowers. These will also be the most controversial cases. While it may be hard to muster sympathy for the giant borrowers of the world, we must accept that, under stronger tying restrictions, they should prevail more easily against banks in tying actions to keep risk at bay.

2. The Breadth of "Borrower"

One question on a more robust Anti-Tying Provision concerns how wide-ranging its effects would be. Does the law affect only a sliver of the economy? If so, perhaps it is inappropriate for the law to be used as a tool against financial risk.

The Anti-Tying Provision touches upon borrowers and potential borrowers from commercial banks. Whether as homeowners, small businesses, or corporate behemoths, broad swathes of the economy can interface with commercial banks at any time as borrowers. This fact, coupled with the strategic

157. E.g., AFP Survey, supra note 6; see also Johnson, Holding Credit Hostage, supra note 5, at 174 ("Syndicated lending has been hit particularly hard because of consolidation.").


159. The purchase of Wachovia by Wells Fargo in 2008 reduced the number of banks whose consolidated assets were above $1 trillion to four banks. For all borrowers, regardless of size and sophistication, choice of lenders has diminished due to bank failures and consolidation. This trend has accelerated since 2008, putting even greater pressure on borrowers to accede to bank conditions. See AFP Survey, supra note 6, at 12; Johnson, Holding Credit Hostage, supra note 5, at 174-75.

160. Two prominent examples are the mishaps of Orange County and Procter & Gamble with derivatives. See Partnoy, supra note 44.
emphasis of banks on tying and cross-selling, would suggest that the Anti-Tying Provision has the potential to affect a large proportion of the economy.

Small businesses, for example, which comprise half of the private sector and provide roughly half of U.S. employment, rely heavily upon commercial banks for financing. U.S. families, too, are saddled with debt. As of 2010, three-quarters of American families held some sort of debt—mostly mortgage debt, followed by installment loans, credit card balances, and lines of credit. Loans and lines of credit to businesses and homeowners are all governed by the Anti-Tying Provision. The potential for violation is as wide-ranging as the demand for credit.

Today, the profitability of lending has been undercut by economic and regulatory developments. Bank officials are wedged between pressures from upper management to maximize profitability and the constraints of Dodd-Frank on some of the most lucrative products of the past. Yet with such a large proportion of the economy in need of credit at any given time, banks—which are the dominant provider of credit—will find it difficult not to tap borrowers for more profitable products and services. Cross-marketing is the natural way to do so, but excessive cross-marketing at some point bleeds into ty-


164. If a loan is issued by a thrift institution, the Home Owners’ Loan Act also imposes tying restrictions. See 12 U.S.C. § 1464(q) (2011); Integon, 989 F.2d. at 1143.


As such, lending may be the frontier at which banks peddle newly devised and as yet unwanted products.

3. **Indirect Regulation of Risk**

Finally, a more vigilant approach to the Anti-Tying Provision may encounter criticism that direct regulation of tied products already exists. For example, established principles of suitability and fiduciary duty bind the sellers of some investment products and services. Yet this Article argues that these alternatives are either nascent or often riddled with loopholes. While the Anti-Tying Provision is not a panacea, it can fill in many of those gaps.

Prior to Dodd-Frank, broker-dealers and sellers of derivatives could successfully maintain that they were not subject to fiduciary duty, the high standard of care and loyalty that binds investment advisers. Instead, broker-dealers were bound by the far weaker suitability standard, which holds that products sold to clients must be “suitable” for their needs, provided that self-dealing is prohibited. The problem with suitability is that it accounts for customer sophistication; it is more difficult to argue that a risky product was not suitable if the purchaser was sophisticated than if the purchaser was unsophisticated. Meanwhile, derivatives dealers could usually be touched only by claims of fraud and misrepresentation—these dealers were likely not under the compunctions of suitability, which derives from the rules of broker-dealer self-regulatory organizations, and they were generally not subject to fiduciary duty either.

Having lived through the failures of pursuing financial institutions on weak theories, lawmakers have learned that sellers of risky financial products should not be able to hide behind the sophistication of their clients. Dodd-Frank therefore commissioned the Securities and Exchange Commission (SEC) to undertake a study on the appropriateness of imposing a fiduciary duty upon broker-dealers. In January 2011, the SEC finished its study and recommended a fiduciary duty

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167. On how tying is already happening on a large scale, see *supra* Part II.C.

168. The problem with suitability is that it accounts for customer sophistication; it is more difficult to argue that a risky product was not suitable if the purchaser was sophisticated than if the purchaser was unsophisticated.


standard for broker-dealers that is consistent with the fiduciary duty of investment-advisers.\textsuperscript{171} Although the principle of a uniform fiduciary duty enjoys broad support,\textsuperscript{172} implementation of the study's recommendations will take time.

As for derivatives sellers, Dodd-Frank also mandated the adoption of business conduct standards that prescribe heightened antifraud and suitability standards.\textsuperscript{173} Yet these standards only curtail the activities of Swap Dealers and Major Swap Participants, entities whose definitions under Dodd-Frank are subject to ambiguity.\textsuperscript{174} Also, the business conduct standards are reserved for special clients such as governments and pension plans.\textsuperscript{175} Hence, our Borrower who purchases an interest rate swap in connection with a loan would not be entitled to these enhanced protections. Finally, these standards will unfold under a lengthy implementation process that is subject to in-

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\textsuperscript{172} Much of the broker-dealer industry suggested even before the study's publication that it would be receptive to a uniform fiduciary standard. See SEI ADVISOR NETWORK \& THE COMM. FOR THE FIDUCIARY STANDARD, A STRONG MAJORITY OF BROKERS AND ADVISORS SUPPORT AND UNDERSTAND KEY ELEMENTS OF A FIDUCIARY STANDARD (Nov. 2009), http://www.seic.com/Advisors/SEI_AdvisorNetwork_FiduciaryStandardReport.pdf.
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\textsuperscript{175} Dodd-Frank § 764(a).
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dustry pressure. Already the rules have garnered charges of being watered down from how they were originally conceived.176

The counterargument that direct regulation of tied products is sufficient, then, falls short of the mark. The Anti-Tying Provision could fill some of the unregulated space in the loopholes of the business conduct standards, as well as the outer valences of the fiduciary duty of broker-dealers before they are fully teased out. The investment products sold by broker-dealer affiliates and derivatives divisions would not be able to tag along to credit unless they are voluntarily obtained by borrowers. The fewer the exceptions to the Anti-Tying Provision, the more it will be able to step in where existing law cannot.

IV.
THE RETURN OF GLASS-STEAGALL

The effect of adopting the recommendations herein—a slower pace to expanding traditional bank product exceptions and a clarification that borrowers need not show actual coercion—would be to sequester risk by walling off certain products and services from credit. This approach is similar to that of the Glass-Steagall Act of 1933 ("Glass-Steagall"),177 which separated commercial banking from investment banking, so as to prevent deposits from being used to play the stock market. In the same spirit, the Anti-Tying Provision would insert a firewall between borrowing and investment activity so that customers are not forced to take on additional risk when they seek out loans.178

This Part casts the Anti-Tying Provision as a continuation of the principles espoused in Glass-Steagall. It begins with a primer on Glass-Steagall, linking it to the Volcker Rule in Dodd-Frank, which bans proprietary trading. This Part then discusses the advantages that stronger tying restrictions possess


177. Also known as the Banking Act of 1933.

178. The firewall is not failsafe, of course. Because the tying restrictions no longer apply to bank holding companies and their nonbank subsidiaries, see 62 Fed. Reg. 9290 (Feb. 28, 1997), these entities in theory have the incentive to tie credit to their products.
over the Volcker Rule in maintaining the firewall between commercial banking and excessive risk.

A. Recapitulation in the Volcker Rule

Numerous commentators have remarked on the uncanny similarities between pre-2008 bank speculation in derivatives and pre-1929 bank speculation in securities. Prior to the enactment of Glass-Steagall in 1933, the lines between commercial and investment banks were blurred. Many commercial banks had engaged in securities activities either directly or through affiliates. After the Great Depression, Congress passed the Glass-Steagall Act, which prohibited commercial banks from dabbling in investment banking activities.

Driving Glass-Steagall was the view that commercial banks had been too intertwined with the stock market through trading and ownership of securities, so when the market collapsed, commercial banks toppled as well. In passing the act, Congress sought to prevent commercial banks from imprudently investing their own assets in stock and from making loans to customers with the expectation that the customers would purchase stock from the underwriter affiliates of the lending banks.

The vitality of Glass-Steagall ebbed and flowed through the next six decades. Gradually, however, the Federal Reserve liberalized the law’s restrictions. In 1999, Congress passed the Gramm-Leach-Bliley Act (“Gramm-Leach-Bliley”), which


180. Commercial banks take in deposits and issue loans, while investment banks raise money for clients—primarily corporate and government clients—through the issuance of stock and debt, advise companies on mergers and acquisitions, and provide investment advisory services.

181. Johnson, Holding Credit Hostage, supra note 5, at 162.

182. See id.

183. Id. at 164; 2 JERRY MARKHAM, A FINANCIAL HISTORY OF THE UNITED STATES, 167-68 (2001).

184. Johnson, Holding Credit Hostage, supra note 5, at 164-65.

185. An oft-cited example is the 1998 order by the Federal Reserve permitting Travelers Group’s acquisition of Citicorp, including Citibank, while retaining Travelers’ insurance underwriting functions and the investment banking activities of its subsidiary Salomon Smith Barney. See FED. RESERVE
eviscerated Glass-Steagall's most powerful provisions.\textsuperscript{186} Commercial banks, whose primary activities consisted of taking deposits and issuing loans, could now be affiliated with entities engaged in nonbank activities, such as insurance, underwriting, and investment advising. Banking organizations could again sell their clients both credit and investment banking services.\textsuperscript{187}

Gramm-Leach-Bliley might have dismantled Glass-Steagall, but the philosophy of delineating deposit-taking activity from investment activity has been resuscitated by the adoption of the Volcker Rule in Dodd-Frank.\textsuperscript{188} The Volcker Rule holds that banks that take in deposits should be prohibited from proprietary trading (i.e., trading in the bank's own account, rather than on behalf of customers) and from owning hedge funds and private equity vehicles.\textsuperscript{189} Conceived by former Federal Reserve Chairman Paul Volcker, the rule was designed to bar banks from making speculative investments. Upon implementation, the rule would mimic the effect of Glass-Steagall by deterring large bank holding companies from owning both deposit-taking and certain investment arms.\textsuperscript{190}

**B. The Anti-Tying Provision as Firewall**

Bolstering the Anti-Tying Provision would have the effect of delimiting borrowing and risky investment activity. As they stand, the traditional bank products consist primarily of staid products, such as extensions of credit, deposit accounts, pay-
ment and settlement services, and payroll services.\textsuperscript{191} Classic investment banking services, such as securities underwriting and strategic advisory services, are forbidden as tied products.\textsuperscript{192} The Anti-Tying Provision, therefore, already works to preserve the demarcation between lending and investment banking, prohibiting the tying of the latter to consumers of the former.\textsuperscript{193} This Article approaches the Anti-Tying Provision from the consumer's perspective, as a limit on how much borrowing can mix with investing.

Strengthening the Anti-Tying Provision is an extension of the philosophy behind the firewalls in Glass-Steagall and the Volcker Rule. That is, products with a significant investment component should be offered as standalone products rather than pushed upon consumers of credit. As proposed in this Article, the way to shore up the Anti-Tying Provision is to transform its demarcation between desired and tied products into a firewall between borrowing and risky investment products. This also maps onto Glass-Steagall's firewall (Figure 4). At its heart, Glass-Steagall was animated by the notion that a financial institution should not mix extensions of credit, which tend to be low-risk, with investment banking activity, which tends to be high-risk.\textsuperscript{194} Extrapolating that principle of comparative risk, the Anti-Tying Provision might be interpreted as a law that seeks to limit the exposure of borrowers to products and services that entail greater risk than loans.

\textsuperscript{191} See Proposed Interpretation, \textit{supra} note 11, at 52030.
\textsuperscript{192} See id. at 52031.
\textsuperscript{193} One critical distinction is that the legality of tying turns on the tied product. The Anti-Tying Provision prohibits the tying of securities underwriting to lending, where a loan is the desired product and securities underwriting is the tied product. However, the tying of credit to securities underwriting, where securities underwriting is the desired product and a loan is the tied product, is acceptable.
\textsuperscript{194} But see Johnson, \textit{Holding Credit Hostage}, \textit{supra} note 5, at 158 ("Large money center commercial banks have been particularly interested in underwriting securities, believing this work to be more profitable and less risky than traditional lending."). That sentiment is debatable; not all underwriting is low-risk.
The two products that have been singled out in this Article—derivatives and securities lending—are far from being staid bank products. While they are certainly not investment banking products, they are nevertheless investment products that carry complex risks to borrowers. For derivatives in particular, the risks are redolent of the dangers targeted by Glass-Steagall and the Volcker Rule in two broad ways.

First, by selling interest rate and credit default swaps, banks in essence act as distributors of swaps. This approximates the role of underwriters in the distribution of securities. The coexistence of lending and underwriting in one banking entity would have run counter to the principles of Glass-Steagall, which viewed this pairing skeptically.

Concomitantly, the sale of derivatives implicates some of the risks of proprietary trading, including systemic risk. As privately negotiated instruments, OTC swaps are beyond the scrutiny of anyone except the counterparties. Yet because of the custom of swaps sellers of “hedging” their risk by buying offsetting swaps, a web of connectivity links multiple parties on any given swap, two counterparties at a time, without any party having full knowledge of the identities of all parties involved. If more borrowers are unnecessarily shunted to swaps via tying, then the larger that web will be and the greater the risk that

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196. Dombalagian lists those risks as moral hazard, conflicts of interest, and market-destabilizing activity (systemic risk). See Dombalagian, supra note 179, at 6-11.

197. Even the counterparties themselves occasionally have difficulty in valuing the payments and default remedies.
failure of one institution will threaten the stability of the entire financial system.198

If adopted, the recommendations in this Article would mitigate the above concerns by installing a barrier between borrowing and certain investment products. The barrier would not be impossibly high, since borrowers could voluntarily opt to buy derivatives and other products. Borrowers just cannot be required to do so in order to obtain a loan or a loan at a certain rate. A more unbending prohibition on tying would reduce the instances of borrowers having to purchase tied products; with that reduction, systemic risk would also be dialed down.

C. The Anti-Tying Provision's Advantages over the Volcker Rule

In the aftermath of Gramm-Leach-Bliley, the Volcker Rule will be the vehicle by which risk is separated from lending and deposit-taking activities.199 Yet implementation of the Volcker Rule is fraught with technicalities. Where it applies, the Anti-Tying Provision may be a simpler alternative to carrying out the goals of the Volcker Rule.

The advantages offered by the Anti-Tying Provision are in recordkeeping and enforcement. Implementation of the Volcker Rule requires bank trading desks to keep reams of daily records that regulators must sift through to determine whether violations have occurred. By sheer volume alone, these records are prone to obfuscation, hiding the true nature of trading activity even as banks claim dutiful compliance to the law.200 Further, banks can skirt the Volcker Rule by regulatory arbitrage if they shift trading activity to the affiliate that is

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198. With Dodd-Frank’s push toward central clearing of OTC derivatives, a handful of clearing entities would serve as the intermediaries between all counterparties. Yet the risk of default on all contracts has simply been shifted to those clearing entities. Systemic risk remains; only its contours have changed. John C. Coffee, Jr., The Political Economy of Dodd-Frank: Why Reform Tends to Be Frustrated and Systemic Risk Perpetuated, 97 CORNELL L. REV. 1019, 1063 (2012).


200. Dombalagian, supra note 179, at 22-25.
overseen by the weakest regulator. Coordination among a plethora of regulators also poses a problem for effective enforcement of the Volcker Rule, as the Federal Reserve, Securities and Exchange Commission, and Commodity Futures Trading Commission all share jurisdiction over proprietary trading.

The Anti-Tying Provision does not suffer from the same difficulties. Enforcement entails fewer regulators (generally, just the applicable bank regulator). In addition, its metrics are not so highly quantitative as to require regulators to pore over logs of daily trading activity. The law's problems with detection and enforcement are mitigated somewhat because borrowers can step in as plaintiffs when regulators fail to detect or prosecute violations. By virtue of the private right of action, the Anti-Tying Provision has an additional set of checks against tying violations: borrower-claimants. Borrowers, who are just as intimately knowledgeable about lending transactions as their banks, can produce the evidence that regulators are unable to cull. The incentive of borrowers to come forward under the Anti-Tying Provision is that, as in general antitrust cases, successful claimants are entitled to treble damages.

V. ANALOGIES FROM ANTITRUST

As a law borne of antitrust principles, the Anti-Tying Provision is sensitive to the changes in tying restrictions under the Sherman and Clayton acts. Major developments in general anti-tying caselaw or theory cannot go unnoticed in the interpretation of the Anti-Tying Provision. This is not to say that the Anti-Tying Provision is so closely calibrated to the Sherman

201. Id. at 27-28.
202. See supra text accompanying note 81.
203. This presumes that borrowers understand when tying violations occur and that they are not loathe to file private actions.
204. 12 U.S.C. § 1975 (2006). The disincentive to bring suit, however, is the fear of jeopardizing relationships with lenders. As of now, most tying cases against banks are filed when borrowers are in default on the underlying loan, after the alleged tie has long transpired. The few borrowers who avail themselves of the Anti-Tying Provision's private right of action, therefore, do so cynically. In a following paper, I will explore protections of borrower anonymity that the law could adopt, so as to enable borrowers to come forward and report illegal tying to regulators earlier.
205. Proposed Interpretation, supra note 11, at 52027.
and Clayton acts that it must march in step to every minor fluctuation. However, general anti-tying principles can be thought of as a floor on all tying practices by financial entities.\textsuperscript{206} If the floor moves up significantly, so too should the baseline for evaluating bank tying practices.

For decades, antitrust scholarship has been dominated by the Chicago School, which holds out efficiency as the primary concern of the antitrust laws and which advocates for a lighter, market-based approach to antitrust regulation. In the wake of the financial crisis, Chicago School adherents have found themselves playing defense.\textsuperscript{207} Disciples of the laissez-faire approach to regulation have tried to distinguish competition policy from financial regulation, arguing that greater scrutiny of the latter should not translate into greater scrutiny of the former.\textsuperscript{208} Since the 1980s, the Chicago School has commandeered the language of antitrust, infusing it with technical terminology and mathematical proofs—at the expense of social and political values.\textsuperscript{209} Today, the pendulum is swinging back toward broader values, without losing any of the analytical rigor of efficiency arguments.\textsuperscript{210}

Recent developments in antitrust scholarship can help to refute two counterarguments to this Article’s proposals. First, the work of Einer Elhauge\textsuperscript{211} serves as an incisive counterpoint against calls to narrow the Anti-Tying Provision to prohibit only those practices that have anticompetitive effects.\textsuperscript{212}

\textsuperscript{206} Where the stricter bank tying restrictions are inapplicable, the Sherman and Clayton acts still govern. For example, bank holding companies and their nonbank subsidiaries are exempt from the Anti-Tying Provision but are still subject to the Sherman and Clayton acts. \textit{Id.} at 52024-25.

\textsuperscript{207} On the rise of the Chicago School, see Jonathan B. Baker, \textit{Competition Policy as a Political Bargain}, 73 \textit{Antitrust} L.J. 483 (2006).


\textsuperscript{210} See, e.g., Kirkwood & Lande, \textit{supra} note 22; Lande, \textit{Wealth Transfers as the Original and Primary Concerns of Antitrust}, \textit{supra} note 22; Elhauge, \textit{supra} note 18.

\textsuperscript{211} Elhauge, \textit{supra} note 18.

\textsuperscript{212} These arguments include the Justice Department memorandum arguing that bank tying restrictions be harmonized with the more lax Sherman Act, as well as comments urging the Federal Reserve to offer a blanket excep-
Elhauge provides theoretical support for the proposition that credit can be used as leverage to diminish competition and harm consumers in a variety of settings.\textsuperscript{213} Another potential criticism is that the Anti-Tying Provision would be transformed into a much blunter instrument than originally foreseen—a prophylactic against risk rather than a chisel directed at competition. To this, the response from general antitrust scholarship is that antitrust law embraces more holistic ideals than just competition or efficiency.

This Part unfolds as follows: First, it looks at the use of credit to achieve two types of anticompetitive effects—leveraging and rate evasion. Second, this Part leaps into the fray on the true measure of harm from tying, be it the welfare of borrowers or a total welfare standard which includes banks. Finally, this Part points to examples of how general antitrust law has accounted for concerns larger than competition and efficiency, a broad perspective which justifies use of the Anti-Tying Provision as a check on financial risk.

A. Anticompetitive Effects

It is well established that Sherman Act and Clayton Act tying analysis proceeds using a \textit{per se} rule. As compared with a more nuanced and deferential rule of reason analysis, the \textit{per se} rule is reserved for a small number of practices that courts have deemed to be typically harmful.\textsuperscript{214} In Supreme Court pronouncements on tying, the \textit{per se} approach remains the law, even if this stricter standard has not been wholeheartedly endorsed.\textsuperscript{215} The debate over the proper standard stems from a split over whether tying adversely affects competition.
This Subpart draws analogies between general tying restrictions and the Anti-Tying Provision to explain why bank tying practices are anticompetitive.

1. Credit as Leverage

a. The vitality of the leverage theory

The oldest criticism of tying (and also the oldest justification of the per se standard) is the leverage theory. It holds that if a monopolist dominates market share in the desired product, then the monopolist can, via tying, leverage that dominance into another monopoly. Hence, two monopolies are created: in the desired product and in the tied product. The monopolist can extract two sets of monopoly profits, forcing consumers to pay more than under only one monopoly.

Since the 1950s, scholars have challenged the presumptions underlying the leverage theory. In this vein, the single monopoly profit theory of the Chicago School has been especially potent. It holds that a monopolist has no need to leverage its power in the desired product market into a second monopoly in the tied product market, because the monopolist can maximize profits by charging more for the desired product. For over half a century, the single monopoly profit theory reigned over the academic literature on tying, notwithstanding the Supreme Court’s pronouncements that per se treatment is appropriate. This gap between caselaw and the academy was bridged by a slew of lower court decisions that chipped away at an unequivocal per se rule. competition and therefore are unreasonable ‘per se.’”

217. Hovenkamp, supra note 17, at 459.

218. Id.


220. Hovenkamp, supra note 17, § 7.9.


222. See, e.g., United States v. Microsoft Corp., 253 F.3d 34, 89-95 (D.C. Cir. 2001) (declining to extend the per se rule to the tying of Internet Explorer to Windows).
In 2009, however, Elhauge defended *per se* scrutiny of tying in several circumstances.223 His argument can be broken down as follows: First, tying can foreclose the tied product market in two ways, which he calls the “foreclosure share effects.”224 Second, tying can create three types of “power effects,” which do not necessarily foreclose the tied product market but nevertheless operate as either price discrimination or extraction of consumer surplus.225 Elhauge evaluates combinations of foreclosure share effects and power effects to explain why these five effects should be condemned. The combinations indicate that the single profit monopoly theory depends on three assumptions: a fixed ratio of desired to tied products, a strong positive demand correlation between the two products, and a lack of substantial tied market foreclosure.226 Without any of the above, the single monopoly profit theory falls apart.

b. As applied to bank tying practices

Bank tying practices do not satisfy the assumptions underlying the single monopoly profit theory (fixed ratio, strong

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224. Specifically, (i) by impairing competitiveness in ways that increase tied product prices and profits or (ii) by increasing the degree of tying market power. *Id.* at 400.

225. Namely, (i) by allowing price discrimination (a) among buyers of the tying product or (b) across buyers of both products or (ii) by extracting consumer surplus from individual buyers. *Id.*

226. *Id.* at 400-01. Elhauge draws from a 1990 paper by Michael Whinston, whose variation of the argument was that the single monopoly profit theory holds only when (i) the tied market is perfectly competitive, (ii) the tied products are complementary, and (iii) the tied products are consumed in fixed proportions. See *id.* at 413 n.31; Michael D. Whinston, *Tying, Foreclosure, and Exclusion*, 80 AM. ECON. REV. 837 (1990). See also EU TYING REPORT, *supra* note 6, at 60-61. Elhauge’s analysis is complex. Under his formulation, single monopoly profits actually result from five assumptions—fixed (i) tied and (ii) tying market competitiveness, (iii) strong positive demand correlation, and fixed usage of the (iv) tied and (v) tying products. Elhauge, *supra* note 18, at 404. However, for our purposes, the simpler three-element formulation suffices. While each of the five assumptions above have been recognized before, their combined effects are more realistic and yet more difficult to model. Elhauge’s conclusion from charting the effects is that single monopoly profits are rare, as such profits rest upon three broader requirements (fixed ratio, strong positive demand correlation, and absence of substantial foreclosure share). See *id.* at 420.
positive demand correlation, and lack of substantial tied market foreclosure). This Subpart will run through sample pairings of credit and tied products, starting with a traditional bank product such as trust services and then moving onto more complicated product linkages, to show where the three key assumptions identified by Elhauge fail.

When trust services are tied to a loan, there is very little correlation in usage or demand between the desired and tied products. Trust services entail the management by a trustee of trust assets in accordance with the terms of a trust agreement.227 These services are generally not complementary to lending. Further, the market for trust services is hardly fixed—at any time, there are numerous providers of trust services beyond banks, including foundations and individuals.228

The same can be said of securities lending services. Borrowers do not always desire or utilize securities lending agents or custody services, so the use of credit is not a good predictor of the consumption of these additional services. Curiously, however, as we move into the realm of more sophisticated services, the competitiveness of the tied product market begins to change. The number of entities that can provide these services dwindles, since these services have such exacting operational requirements. Consolidation in the custody industry, for example, has become commonplace, so that a handful of banks dominate the custody (tied product) market today.229 Yet even if the tied product market is not competitive, securities lending services still do not meet the first two assumptions for the single monopoly profit theory to hold.

When we turn to swaps, the interplay between tying and the single monopoly profit theory is at its most complicated. Swaps tend to be paired with other financial instruments, because a swap’s value is pegged to the value of an underlying


228. However, institutional management of trusts has experienced consolidation in recent years. See Amy Oxley et al., A LOOK BACK ON A QUARTER-CENTURY OF DEATH AND DIRT, 26-FEB PROB. & PROP. 10, 11 (2012) (noting a drop in the number of institutions managing trust assets).

229. See Chan et al., supra note 69, at 21 (noting that in the foreign securities market, the top 10 custodians held 77% of the securities in 2005, and that the domestic market is dominated by four players).
obligation. Demand between loans and swaps should correlate positively and strongly, as there would be little reason to purchase a swap in the absence of an underlying credit. The ratio of usage of loans and swaps should also be relatively fixed, as borrowers have no reason to purchase multiple swaps on any given loan. In these ways, two of the three assumptions buttressing the single monopoly profit theory seem to apply.

The third assumption for the single monopoly profit theory—the competitiveness of the tied product market—presents the greater analytical challenge. Derivatives trading is dominated by four or five large banks. The Office of the Comptroller of the Currency (OCC), which compiles quarterly reports ranking bank derivatives positions, reveals that the same six banks almost always top the list: JPMorgan Chase, Bank of America, Goldman Sachs, Citibank, Wells Fargo, and HSBC. Thus, the derivatives market (the tied product market) is largely foreclosed. Coincidentally, in lending (the desired product market), the four largest US commercial banks have consistently been JPMorgan Chase, Bank of America, Citibank, and Wells Fargo. Collectively comprising the “league of trillionaires,” because the consolidated holdings of each of

230. Swaps complement credit so closely that it challenges our intuitions about whether two products are being sold. Tying requires the sale of two separate products, the test for separateness being whether the “tying item is commonly sold separately from the tied item in a well functioning market.” HOEVENKAMP, supra note 17, at 453. Banks have argued that swaps and credit are in fact one product. See, e.g., Johnson, Banking, Antitrust, and Derivatives, supra note 5, at 24-26; ABASA Comment Letter, supra note 76, at 7-9. Despite the close functional fit, swaps and credit do meet the test for separateness; for each can be sold separately in an open market.

231. OCC’s FOURTH QUARTER 2011 REPORT, supra note 57, at 1 (“Derivatives activity in the U.S. banking system continues to be dominated by a small group of large financial institutions. Five large commercial banks represent 96% of the total banking industry notional amounts and 86% of industry net current credit exposure.”).

these entities surpass the trillion-dollar mark\(^{233}\) these are also the banks most likely to arrange loan syndications.\(^{234}\)

The correlation between the largest commercial banks and the largest derivatives traders is not happenstance. This correlation can be explained in two possible ways: either leverage of credit or pre-existing barriers to entry in the swaps market.

First, perhaps the trillionaires have leveraged their way into dominance in the derivatives market via their dominance in the credit market. Suppose, for example, that a large Fortune 500 company ("Big Borrower"), which is the borrower in a syndication, is told by the lead agent ("Big Bank"), a dominant player in the syndication market, that its services are contingent upon Big Borrower purchasing an interest rate swap from Big Bank. Big Borrower feels it has no choice and relents. Over time, the repetition of this scenario with other borrowers could enable Big Bank to preempt the entry of competitors into the interest rate swap market. Other banks might be willing to sell interest rate swaps, but Big Bank has cornered the swaps market by lending money to all the potential swaps buyers and then preventing them from obtaining swaps elsewhere.

Alternatively, the derivatives market might be foreclosed by the technical barriers to entry. Derivatives trading requires sophisticated operational capacities.\(^{235}\) While small- and mid-sized banks can participate in the swaps market,\(^{236}\) the players

\(^{233}\) As of third quarter 2012, the consolidated assets of the largest four banks were $1.85 trillion for JPMorgan Chase, $1.45 trillion for Bank of America, $1.37 trillion for Citibank, and $1.21 trillion for Wells Fargo. The fifth biggest bank, US Bank, lagged nearly one order of magnitude behind at $341 billion. See id.


\(^{236}\) See Johnson, Banking, Antitrust, and Derivatives, supra note 5, at 15 ("Even smaller banks have earned significant profits from their involvement with OTC derivatives.").
may have to outsource many of the expensive "back office" functions to larger banks.\textsuperscript{237} The swaps market has thus been overtaken by the league of trillionaires.\textsuperscript{238}

If the trillionaires have leveraged their way into the swaps (the tied product) market, then tying would be anticompetitive. If the swaps market were simply uncompetitive because of high barriers to entry, then the single monopoly profit theory would not apply, and there would be the propensity for leverage. Either way, tying would usher in anticompetitive effects.

2. Tying as Rate Evasion

Rate evasion occurs commonly in industries where output price is set by regulation—for example, in utilities, where the players are often true monopolies. Frequently, the set price is lower than the producer’s profit-maximizing price, in which case the producer will tie other products or services to the consumer’s purchase of the desired product.\textsuperscript{239} The tied products will not be subject to price controls; charging more for the tied products allows the producer to recoup the lost profits from the desired product.\textsuperscript{240} While the body of cases on rate evasion is not as voluminous as on leverage, courts have found producers liable where tying is used to evade price controls on the desired product.\textsuperscript{241} The Justice Department, too, has condemned price evasion in its guidelines on vertical mergers.\textsuperscript{242} Price evasion harms competitors in the tied product market (because producers can leverage their monopoly in the desired product market) and consumers (because consumers are forced to pay more).\textsuperscript{243}

\textsuperscript{237} Cf. \textit{id.} at 17-18 (detailing how smaller banks can participate in the derivatives market despite a lack of trading and back office support).
\textsuperscript{238} Over 95\% of the notional amount of all derivatives positions can be traced to the five largest players. \textit{See} OCC’s Fourth Quarter 2011 Report, \textit{supra} note 57.
\textsuperscript{239} \textit{See} Hovenkamp, \textit{supra} note 17, at 464.
\textsuperscript{240} \textit{Id}.
\textsuperscript{243} Hovenkamp, \textit{supra} note 17, at 464.
In the banking sector, tying can be used to evade low interest rates, which have hovered in the single digits since the financial crisis. In the non-syndication markets in particular, intense competition among banks tends to keep spreads very close to these low rates. Another source of downward pressure on rates is the Federal Reserve itself, which has set rates low so as to spur lending. These trends have the effect of mimicking a regulated industry where output must adhere to fixed prices. While banks are certainly free to set their rates far in excess of the prime rate or LIBOR, market and governmental pressures force banks to keep rates low. Banks therefore can respond by tying other services at a markup to offset the lower profitability of lending. High markups for, say, trust services, asset management, and swaps avoids the effect of the de facto rate regulation.

To expound upon general antitrust rationales for striking tying as a rate evasion mechanism, we can analogize the harm suffered by competitors under rate evasion scenarios as a type of harm inflicted through leverage by a dominant player in the desired product market. In the tied product market, financial service providers may have difficulty selling swaps because the potential buyers happen to be borrowers who end up obtaining swaps from dominant lenders. Simultaneously, in the desired product market, lenders that do not tie may be injured by lenders that tie. A non-tying lender might only be able to offer a variable-rate loan at prime rate plus 6 percent, while a lender that ties can offer a rate of prime rate plus 5 percent and then make up the lost profits by charging more for tied products. The borrower who shops for loans by comparing only the interest rates may forego business with the non-tying lender.

From a normative standpoint, there may be little reason to sympathize with the non-tying bank; it has failed to invest in the ability to offer a diverse menu of products from which to capture lost profits from lending. Yet if we turn to the harm to consumers from rate evasion, we may find stronger cause to condemn tying. This is because borrowers are paying higher prices for tied products, although that fact is obscured by

244. See id. at 465 (noting that consumers are harmed either because tying pushes the price of the tied product above their reservation price or, more
the "discount" on the loan. This propensity of tying to obfuscate is at the heart of objections to the practice.\textsuperscript{245}

3. Significance

One conclusion of applying Elhauge’s theory is that a commercial bank that holds a large share of the credit market may use that dominance to leverage into higher profitability and larger shares of markets in various tied products. The use of credit as leverage or rate evasion would create anticompetitive effects for competitors and consumers. Speculations that bank tying does not produce anticompetitive effects are inappropriate.\textsuperscript{246}

Another conclusion is that Elhauge’s theory vindicates the strict \textit{per se} treatment of bank tying practices. If tied products, ranging from traditional bank products to more complex swaps, threaten the integrity of competitive markets, then a bright-line approach will be more efficient than a deferential standard that permits inquiry into anticompetitive effects with each action.\textsuperscript{247}

B. Efficiency Versus Consumer Welfare

1. The Resurgence of Consumer Welfare

Antitrust scholars have spilled much ink on the proper measurement of harm under anticompetitive practices. One camp, comprised of efficiency-minded scholars, judges, and enforcers, advances a "total welfare" standard, which would permit practices whose benefit to producers outweighs the harm to consumers.\textsuperscript{248} The most well-known proponent of this

\textsuperscript{245}See U.S. \textsc{Department of Justice}, \textit{supra} note 242, § 4.23 (articulating rate evasion challenges to vertical mergers). The Non-Horizontal Merger Guidelines provide the example of a regulated utility company purchasing its supplier, after which the utility company could arbitrarily inflate the prices that it pays to the supplier and then pass those inflated prices off to consumers as legitimate costs.

\textsuperscript{246}But see DOJ Letter, \textit{supra} note 20 (arguing that bank tying practices do not lessen, but may actually increase, competition).

\textsuperscript{247}But cf id. (decrying the \textit{per se} standard under the Anti-Tying Provision).

\textsuperscript{248}See, e.g., Alan Devlin & Bruno Peixoto, \textit{Reformulating Antitrust Rules to Safeguard Societal Wealth}, 13 \textsc{Stan. J.L. Bus. \& Fin.} 225 (2008); David S. Evans
perspective is Robert Bork, whose analysis of the Sherman Act in 1966 paved the way for the Chicago School’s argument that the benefits to monopolists and cartels should be factored into the total calculus of efficiency, as an offset to consumer harm.\textsuperscript{249} For the ease of reference, we will call this group the “efficiency” camp.

Another camp maintains that antitrust law should only account for consumers in measuring harm.\textsuperscript{250} As justification, this group points to the legislative history of the Sherman Act and Supreme Court and lower court decisions, whose concerns seem to revolve only around “consumers.”\textsuperscript{251} Lower prices, better products, and more choice are all pro-consumer goals of competition policy to be heralded above efficiency.\textsuperscript{252} We will refer to this camp as the “consumer welfare” camp.\textsuperscript{253}

Whether one focuses narrowly on consumers or broadly on a totality which includes producers in turn dictates one’s willingness to sanction tying practices. Efficiency scholars are quick to point out the efficiencies inherent in tying, which translate into reduced costs that theoretically get passed onto consumers as reduced prices.\textsuperscript{254} Yet consumer welfare scholars argue that gains from anticompetitive practices are at the expense of consumers.\textsuperscript{255}


\textsuperscript{251} See Kirkwood & Lande, supra note 22; Elhauge, supra note 18, at 438.

\textsuperscript{252} Kirkwood & Lande, supra note 22, at 192.

\textsuperscript{253} Another way to think of the efficiency-consumer welfare dichotomy is as a schism between Kaldor-Hicks and Pareto efficiency. The efficiency camp would not strike anticompetitive practices that benefit one group (producers) more than they hurt another (consumers). Such practices would be Kaldor-Hicks efficient.

\textsuperscript{254} See Devlin & Peixoto, supra note 248, at 257.

\textsuperscript{255} Kirkwood & Lande, supra note 22, at 220. For tying specifically, producers can use product linkages as a price discrimination mechanism disproportionately siphons surplus from heavy users of a tied product. The literature on price discrimination is rich. For a recent assessment, see Erik Hovenkamp & Herbert Hovenkamp, \textit{Tying Arrangements and Antitrust Harm}, 52 Ariz. L. Rev. 925 (2010) (showing that there are many different forms of
The common argument of efficiency scholars against the consumer welfare standard in tying is that no consumer profit can be extracted in the tied market. This argument rests upon (i) the single monopoly profit theory, which undercuts the claim of leverage, and (ii) the fact that tying occurs in competitive markets, where abuse of consumers is difficult. Hence, there must be non-consumer-welfare-extraction reasons to tie. Put differently, tying must be to serve producer efficiencies only (rather than extracting consumer surplus).

2. Borrower Welfare, Not Banking Welfare

A consumer welfare standard applied to bank tying practices would translate to borrower welfare. A total welfare standard would pit the gains to financial institutions against the losses to borrowers; if the former outweighs the latter, tying will be deemed Kaldor-Hicks efficient. With the hindsight of scandal after scandal from the financial crisis, evaluating bank tying practices from the total welfare perspective seems untenable.

While giving free reign to banks to tie financial products would produce numerous benefits to banks, the risks presented to borrowers from untested products, as well as to the economy as a whole from the injection of risk, cannot be justified by simply adding up the costs and benefits. Here the analogies between antitrust and financial regulation are not so straightforward. The maximization of profits is presumed to have a component of self-correction in antitrust regulation, due to competition and passing profits through to consumers. Yet there is good cause to be skeptical of profit maximization in the banking industry, which leads perversely to price discrimination and that consumer welfare only suffers under a few of them).


257. It would be hard to imagine, for instance, any defense of the manipulation of LIBOR by the cartel of banks which set the rate, even if the gains to the cartel outweigh the losses to investors and consumers. Even more to the point, for our purposes, the fallout of LIBOR would not have been so vast had interest rate swaps pegged to LIBOR not been pushed upon small and medium-sized borrowers. See supra text accompanying notes 100 and 101.

258. See Devlin, supra note 208.
This skepticism would counsel for a stricter standard in the regulation of bank tying, one that focuses narrowly on borrowers in evaluating harm.

The counterarguments offered up by efficiency scholars in defense of a total welfare standard are either misplaced or inapplicable to bank tying. First, the single monopoly profit theory, which supports the total welfare standard has been called into question. Second, the invocation to competition in the desired and tied product markets is not neatly applicable to banking. The banking industry is at once uncompetitive and ultracompetitive, but even in uncompetitive segments, tying can be used to reduce competition.

At the elite level, competition is scarce. The banks that dominate loan syndications tend to be the same trillionaires that have also cornered the derivatives market. The majority of banks simply do not have sufficient assets to arrange for syndications or to invest in the “back office” infrastructure necessary to carry out the operational tasks of derivatives trading or securities lending. Where tied products are complex, then, opting for the borrower welfare standard should be uncontroversial. After all, the banks affected would be the same entities that enjoy little competition.

At the level of commodity products such as deposit and trust services, competition is intense. Here, it is the industry’s

259. A fuller quote on this point from Devlin, a defender of efficiency who actually comes down hard on the banking industry, is compelling:

The incentive to maximize profits, which fuels the self-correcting nature of the market in antitrust cases, causes problems in the banking industry. Here, faith in the market is in many ways reversed . . . . The pursuit of ever-greater profits in the banking sector, which is magnified by risk-taking incentives in the form of FDIC insurance, securitization, and high discount rates, will not yield a desirable and stable equilibrium. *Id.* at 588-89.

260. See Elhauge, supra note 18.

261. Competition in the desired product market means that leverage is not possible; competition in the tied product market means that tying is not profitable. Evans & Salinger, supra note 248, at 88-89.

262. The AFP Survey demonstrates the leverage that lenders to large companies wield, due to the smaller pool of banks. On the tendency of banks to compete intensely by mimicking each other, see Jonathan R. Macey & James P. Holdcroft, Jr., *Failure Is an Option: An Ersatz-Antitrust Approach to Financial Regulation*, 120 *Yale L.J.* 1368, 1383-85 (2011) (detailing the lemmings-like behavior of banks).
model to create financial products and then push them relentlessly in the narrow window before competitors copy the products and begin doing the same. However, there are still challenges to the adoption of a total welfare standard. Empirically, there are strong indications that credit is often used as leverage. Credit is, after all, the desired product that foments a relationship between a borrower and a bank. The AFP Survey indicates that in order to access credit in today's market, borrowers must reach a threshold of overall profitability for the bank to enter into a lending relationship. This profitability will not likely be met by lending, because rates are so low, but can be met through the purchase of other products and services. If borrowers assent to the purchase of those tied products and services, the bank will lend; if not, the bank will forego the relationship. This all comes about solely because of the power of credit, which can be a lifeline to many businesses and families.

C. The Goals of Antitrust Law

1. Economic Versus Social and Political Concerns

The debate surrounding the ultimate goals of antitrust is as old as antitrust law itself. The deepest schisms have occurred over whether those goals, such as the protection of social, moral, and political concerns, are economic or noneconomic. For the most part, the economic camp has prevailed, and here, as elsewhere in antitrust, the Chicago School's efficiency approach has been dominant. Since the 1970s, scholars who back the efficiency approach have managed to frame antitrust as a set of laws that safeguard eco-

263. See Partnoy, supra note 44. Swaps, too, have been commoditized somewhat. See Maurice E. Stucke, Lessons from the Financial Crisis, 77 Antitrust L.J. 313, 332-33 (2010) ("[A]s it relates to the financial crisis, J.P. Morgan innovated with new forms of credit default swaps precisely because competing investment banks copied prior financial innovations and industry margins were eradicated . . .").
264. See supra text accompanying notes 152-55.
265. See AFP Survey, supra note 6, at 10.
266. For a succinct summary, see Lande, Wealth Transfers as the Original and Primary Concerns of Antitrust, supra note 22, at 67-79.
267. Id.
nomic efficiency. Other concerns have been dismissed as "intellectual mush" and "poetry." Nonetheless, due to its unbending exclusion of alternative goals of antitrust, some of the Chicago School's precepts have been challenged.

In defense of social, moral, and political goals in antitrust law, other scholars have evoked Jeffersonian ideals of dispersion of power. The skepticism of concentration of power in the Sherman and Clayton acts bespeaks, for instance, a fear that corporate influence can smother political freedoms. Other challenges to the pre-eminence of efficiency have been more modest and cabined within an economic rubric—for example, the argument that the antitrust laws were passed to further the distributive goal of "preventing unfair acquisitions of consumers' wealth." The challenge to these positions, especially the further one gets from economic analysis, is that social and political goals are often seen as unworkable, in both definition and analysis.

Arguments for social and political goals were most vigorous in the 1980s, with the ascendancy of the Chicago School during the Reagan administration. These arguments then


271. Although on the whole Hovenkamp takes an economic approach to antitrust analysis, he nevertheless acknowledges that there is room for noneconomic concerns. See Hovenkamp, supra note 17, at 77 ("Much of the Chicago School analysis is written as if there were only one antitrust statute and it read 'Promote business efficiency.' But that is not the antitrust statute that we have. The antitrust student begins with a body of statutes in which economic efficiency plays a disturbingly small part . . . . [C]ompeting concerns . . . simply cannot be ignored. If they are, then we are not living in a democratic society.").

272. See Barnes, supra note 270.

273. See id.

274. Lande, Wealth Transfers as the Original and Primary Concerns of Antitrust, supra note 22, at 70.

275. See Barnes, supra note 270, at 806.
waned for decades—until the financial crisis propelled the old debates to the forefront of antitrust circles again. Some have recently called for a more prominent role for the "populist school" of the 1960s and 1970s, which focused on firm size, political influence, and other noneconomic goals.276 Others have cautioned against an over-reactive course correction that sidelines economic analysis.277

2. Risk as Economic and Noneconomic Interest

As between the two poles of economic and noneconomic interests, the goals of the Anti-Tying Provision would appear to be simple: economic. Its legislative history references concerns about "misuse of economic power" and "fair competition" by banks.278 Yet that history also makes clear that the Anti-Tying Provision is not to interfere with "appropriate traditional banking practices,"279 a topic that was taken up during the passage of the 1970 Bank Holding Company Act Amendments, of which the Anti-Tying Provision is part and parcel. Discussion of traditional banking practices involved a "public interest standard" by which innovation and expansion into nonbanking activities was to be evaluated.280 Hence, the expansiveness with which we might read the Anti-Tying Provision in the service of noneconomic goals is not entirely settled by looking at legislative history.

If we are to fill in the gaps by turning to general antitrust law, it would not be a great stretch to slot risk into either the economic or noneconomic paradigms. Risk can be couched as an economic concern, since the assessment of risk is but an estimation of the potential for financial and economic damage. The injection of risk into bank tying analysis does not require significant departures from the dominance of economics in antitrust, just that the focus is broadened from efficiency. And if risk implicates noneconomic concerns, then from current developments in antitrust policy we know that there

277. See Devlin, supra note 208.
278. Senate Report, supra note 30, at 5535.
279. Id.
280. Id. at 5532-33.
should be room to consider the social, political, and moral components of sequestering financial risk as well.\textsuperscript{281}

Of course, bank tying restrictions are a different matter than general antitrust considerations, so the analogies can only go so far. After all, the Anti-Tying Provision was intended to be more rigorous than its Sherman and Clayton Act counterparts,\textsuperscript{282} and the centrality of banking to the economy has no parallels.\textsuperscript{283} Even defenders of a laissez-faire approach to antitrust must concede that the alignment of profit-maximization with risk-taking in banking merits a stronger regulatory regime.\textsuperscript{284} On balance, then, if it comes down to a choice between expanding versus maintaining the understanding of the Anti-Tying Provision so as to accommodate the analysis of risk, it would seem that regulators should err on the side of expansion.

Finally, lest there be fears that the consideration of risk would transform the Anti-Tying Provision into an unwieldy forum, it should be mentioned that risk might be challenging to quantify, but it is not impossible to assess. Experienced regulators and risk officers understand how to assess the likelihood of future catastrophes in accordance with present-day benchmarks. Risk is therefore not as protean as other political, social, and moral goals of antitrust, and arguably risk is no more difficult to pin down than efficiency.

VI. CONCLUSION

The Anti-Tying Provision has weathered several rounds of changes in regulatory philosophy over the 42 years since its enactment. The law has gone from an ambitious anti-tying prescription to a set of exceptions-laden rules that was powerless

\textsuperscript{281} There is indication in the Anti-Tying Provision's legislative history that the law had envisioned "small independent businessmen" as its beneficiaries. See Conference Report, supra note 116, at 5580. This term is reminiscent of Jefferson's image of an egalitarian, agrarian society where large businesses play a small role.

\textsuperscript{282} See Proposed Interpretation, supra note 11, at 52027.

\textsuperscript{283} See Senate Report, supra note 30, at 5520 ("[B]ecause of the importance of the banking system to the national economy, adequate safeguards should be provided against undue concentration of control of banking activities . . . ").

\textsuperscript{284} See Devlin, supra note 208.
as banks tied the types of risky products that brought down the global financial system in 2008. In many ways, the evolution of the Anti-Tying Provision has been a compressed recapitulation of developments in general anti-tying law.

Today, the need for stronger bank tying restrictions is paramount. As banks devise new products to make up for tighter profit margins, it is likely that those new products will make their way onto the market by way of borrowers, as products tied to loans. Recent scandals of aggressive cross-selling and mis-selling of interest rate swaps bundled with loans portend an environment where risky products will continue to be pushed upon purveyors of credit.

A more robust Anti-Tying Provision would be an elegant response to increased experimentation with, and cross-selling of, risky financial products. The provision already has a built-in firewall between loans and riskier products that mimics Glass-Steagall’s separation of commercial and investment activity, as well as the Volcker Rule’s purging of risky trading and investment activity from commercial banks. The provision also encapsulates many of the policy considerations underlying general antitrust law, such as promotion of competition, protection of consumers, and pursuit of a broad array of goals.

As regulators and industry in banking adjust to the post-2008 landscape, all sides may find that sensible solutions lie in antitrust law. With its voluminous case law and scholarly output, antitrust law provides a flexible framework which is adept at balancing a myriad of interests. Many of the problems plaguing financial institutions today are some variation of antitrust problems. Banking and antitrust law will likely converge to solve these problems, and existing financial regulations that incorporate antitrust principles—such as the Anti-Tying Provision—will enjoy resurgence and heightened prominence.

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285. For example, the LIBOR scandal, increasing consolidation, and the dominance of the trillionaires in several product markets.