Mellon

Mellon Financial Corporation

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September 29, 2003

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

Re: Docket No. OP-1158; Proposed Interpretation of Anti-tying Restrictions

Dear Ms. Johnson:

Mellon Financial Corporation, Pittsburgh, Pennsylvania ("Mellon"), welcomes the opportunity to comment on the proposed interpretation (the "Proposed Interpretation") of the anti-tying restrictions of Section 106 of the Bank Holding Company Act Amendments of 1970 (the "Tying Rules") and related supervisory guidance (the "Guidance") recently issued by the Board of Governors of the Federal Reserve System (the "Board"). As discussed in more detail below, Mellon generally supports the Board's action in the Proposed Interpretation and offers the following as suggested refinements with respect to (i) what constitutes a single product, (ii) customer-initiatedties, (iii) the scope of traditional bank products, **and** (iv) standards regarding mixed-product arrangements.

1. Two Products v. Single Product

As the Board noted in its Proposed Interpretation, in order for a tying arrangement to exist under the Tying Rules, two or more separate products must be involved. The Board found that as a general matter, two products will be found separate and distinct for purposes of the Tying Rules only if there is sufficient demand for each of the products individually such that it would be "efficient" for the bank to provide the two products separately. Mellon believes that this approach has merit; the economies and efficiencies gained by offering intrinsically related products as a package, will inure to the bank's benefit and (because the bank will be in position to pass on savings and expedited processes) also to the customer's advantage.

The provision of complementary derivative products in connection with bank loans is illustrative. If a bank makes a floating rate loan to a borrower, the bank may, consistent with sound business practice and prudent credit judgment, require the borrower to hedge its exposure to interest rate

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fluctuations by obtaining interest rate protection in the form of a derivative. This protection could be obtained by the customer from other institutions; however, it is clear that reliance upon third party protection will require the bank to take several additional steps to attempt to put itself in the same position it would be in had the lending bank itself provided the derivative. The bank must, at a minimum, assess and underwrite the credit strength of the swap counterparty and attempt to ensure that the swap and loan obligations are cross-defaulted to one another; the bank should also find a way to ensure that it receives notice of matters affecting the hedging arrangements. Clearly, these measures inevitably increase the administrative burden and probably the actual costs to the bank of providing the loan products on a stand-alone basis. In such circumstances, Mellon believes that forcing the rate swap to be justified as a separate product is inappropriate and unnecessarily burdensome.

Similar concerns arise in the context of an equity derivative related to a bank loan secured by stock. In such circumstances, the bank's credit judgment may mandate that the stock collateral be protected from significant decline in value by means of an equity collar. Here too, protection in the form of a collar could be obtained from other parties; however, the bank would again be required to underwrite the credit of the swap provider as well as ensure that the loan **and** swap documentation are structured to preserve the protection mandated by the bank. Moreover, since the swap bank may wish to require the pledge of the (collared) shares to secure the swap exposure (which shares the lending bank is of course relying upon) substantial intercreditor issues would require resolution. The result of these issues is, at minimum, to increase the cost to the bank of providing only one of these products and the cost to the customer of obtaining the complementary products from different sources.

For these reasons, Mellon urges the Board to recognize that where a derivative product is intrinsic to a loan transaction and a bank's effort to preserve either the value of the collateral (e.g. by means of an equity collar) or the borrower's ability to meet its payment obligations (i.e. interest rate or currency hedging arrangements), the derivative associated with these efforts should be considered part of the loan product for purposes of the Tying Rules.

Mellon also urges the Board to expressly recognize that many derivative products can (even apart from any association with a loan) qualify as traditional bank products. For example, foreign exchange transactions, whether spot, forward or currency swaps, have long been intrinsically related to the offering of deposit and collection products for various currencies. Similarly, should a bank write a credit derivative on a borrower, the transaction is in key respects the functional equivalent of issuing a standby letter of credit to support a particular borrower which is, itself, a traditional loan product. Thus, the credit derivative may be viewed as a loan product, albeit in a new form.

2. Customer-initiated Situations

Mellon applauds the Board's confirmation that a customer-initiated tie does not violate the Tying Rules, even if the same tie would have violated the rule if a bank had unilaterally imposed it. This is a matter of particular significance to Mellon, as it has moved from an institution with an active business of lending to institutional borrowers to an institution stressing asset management and corporate and institutional services. As Mellon has made this transition, it has commonly been faced with customers who insist that it extend credit as a condition to the customer buying some other product or service from it.

Because the bulk of Mellon's non-credit products are traditional bank products within the meaning of the Tying Rules, Mellon can accommodate many of these customer demands in ways that would not violate the Tying Rules. However, the Board's clear affirmation that customer-initiated ties do not violate the rules even when the bank is offering a non-traditional product will be helpful.

Based on Mellon's experience with customer demands for credit, Mellon urges the Board to shape the factual inquiry into whether a tie was initiated by a customer with an eye to the realities of the marketplace. It is Mellon's experience that customers need not be particularly sophisticated or have great financial resources to insist on these types of ties. The Board should not give great weight to the relative sophistication of customers or the scope of their financial resources in determining whether the customer or the bank initiated the tie. Mellon urges the Board to declare affirmatively that no negative inference will be drawn from a bank reducing a customer-initiated tie to a binding contract and then insisting on getting the benefit of the bargain. If a customer requires a bank to extend credit as a condition of the customer buying a non-traditional product from the bank or an affiliate, the bank should be able to enforce the bargain without any inference being drawn that it initiated the tie.

3. Traditional Bank Products

Mellon generally supports the Proposed Interpretation's discussion of the traditional bank products exception to the anti-tying prohibition. However, Mellon believes the discussion should be expanded in two respects. First, Mellon urges the Board to expressly state in the Guidance, that "traditional" bank products may rest upon new and innovative technologies or methods of delivering products or services; this recognition would entail mention of the fact that the precise form of loan, deposit or trust products will continue to evolve in response to technological changes and marketplace developments without thereby destroying the underlying traditional nature: of a particular product for purposes of the Tying Rules. (For example, debit card services and arrangements have replaced paper checks in many contexts; despite the fact

that debit cards were essentially unknown when the 1970 amendments to the Bank Holding Company Act were enacted, such products are clearly traditional deposit products albeit in a new technological guise.)

Second, Mellon believes that since the Board has elected to include a list of products and services found to be traditional, that list should also include the following:

- foreign exchange products and services, whether spot or forward and where offered to retail or institutional customers;
- all investment advisory services;
- corporate trustee services; and
- services provided as a trustee and/or custodian under or in connection with employee benefit plans.

4. Mixed-product Arrangements

Mellon also applauds the Board's recognition that mixed-product arrangements can and should pass muster under the Tying Rules. However, Mellon joins with the comments of the ABA Securities Association and the Financial Services Roundtable regarding the standards that the Board has proposed to judge the permissibility of a mixed-product arrangement.

The Board appears to be proposing a process that would require a bank offering a mixed-product arrangement to a customer to determine whether the arrangement is permissible based on the specific customer and the specific transaction. As Mellon understands it, a bank would have to satisfy itself that a customer being offered a mixed-product arrangement could meet the requirements of that arrangement solely by buying traditional bank products, based on that customer's specific circumstances at that specific time. Mellon believes that this approach would be unworkable in practice and unnecessary to assure that mixed-product arrangements comply with the Tying Rules.

A customer-by-customer, transaction-by-transaction approach would be unworkable in practice. It would require banks to expend significant resources to examine and analyze each customer's needs at the time that a mixed product arrangement is offered. It would require banks to delve into details of customers' relationships with other sellers of traditional bank products in ways that customers would likely not countenance. It would require significant time spent comparing the customer and its likely demand for traditional bank products to the demands of other customers analyzed as being equivalent.

A customer-by-customer, transaction-by-transaction approach is also unneeded and undesirable from a policy perspective. This approach will restrict the availability of mixed-product arrangements in situations where they would benefit banks and their customers. Such a fact-intensive analysis would be an invitation to litigation, with attempts by plaintiffs to discover the bank's analyses for all of its customers. Fears of litigation and second-guessing will in turn drive banks to take a conservative view of the standard and offer mixed-product arrangements only in cases where they believe that they have absolutely ironclad defenses against a challenge. This will result in mixed-product arrangements being denied to customers in situations where both customers and banks could benefit from such offerings.

Instead of an approach focused on individual customers, Mellon urges the Board to articulate a standard by which a bank can structure a mixed-product program based on the bank's reasonable good faith perception of the general product needs of the customer base to which the program is pitched. This will make clear that banks can consider the needs of a customer base as a whole, rather than focusing on the needs of each customer when that customer is offered the program. That in turn will encourage banks to offer complying programs to benefit the broadest customer base without undue litigation risk or compliance burden.

Finally, Mellon notes the Board's concerns regarding banks offering mixed-product arrangements to individuals. Because Mellon no longer operates a retail banking franchise, it leaves it to others to comment on the validity of the Board's concern in the normal retail context. But Mellon does urge the Board to consider whether its concerns are merited in the case of private banking customers.

In Mellon's experience, private banking customers present distinctly different issues under the tying rules than do retail banking customers. First, private banking customers clearly possess considerable bargaining power and sophistication. Second, their business is sought after in a highly competitive environment populated by banks and bank competitors offering a wide variety of products in a wide variety of settings. There is practically no chance that these customers would succumb to the "subtle pressure" to accept ties alluded to by the Board. Third, these customers are most likely to demand, and to benefit from, a wide range of products and services offered by a private bank and its affiliates – including products that do not fall into the traditional bank product category. This makes them natural prospects for the benefits of mixed-product arrangements.

For these reasons, Mellon submits that the standards used to judge the permissibility of offering mixed-product arrangements to private banking customers should be no different than the standards applicable to other non-retail customers.

Mellon appreciates the opportunity to submit these comments on the proposed interpretation of the Tying Rules of Section 106 of the Bank Holding Company Act Amendments of 1970 and the Guidance recently issued by the Board. If you have any questions, please contact me at 412-234-1537.

Respectfully submitted,

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