THE FINANCIAL SERVICES ROUNDTABLE

September 30, 2003

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551
Attention: Docket No. OP-1158

Re: Proposed Interpretation and Supervisory Guidance Regarding the Anti-Tying Restrictions of Section 106 of the Bank Holding Company Act Amendments of 1970

Dear Ms. Johnson:

The Financial Services Roundtable ("the Roundtable") is a national association that represents 100 of the largest integrated financial services companies providing banking, insurance, investment products, and other financial services. The member companies of the Roundtable appreciate the opportunity to comment to the Board of Governors of the Federal Reserve System (the "Board") on the proposed interpretation and supervisory guidance regarding the anti-tying restrictions of section 106 of the Bank Holding Company Act Amendments of 1970.

Background

Section 106 of the Bank Holding Company Act Amendments of 1970 (the "Act") generally prohibits a bank from conditioning the availability or price of one product on a requirement that the customer also obtain another product from the bank or an affiliate.

The need for an interpretation of the Act has been more pressing in recent years, especially with the passage of the Gramm-Leach-Bliley Act ("GLBA") which gave financial institutions the ability to offer many different products, including investment and insurance products, to their customers through their affiliates and subsidiaries. The GLBA has increased competition in the marketplace giving customers the choice of an array of products and services and providing them with the opportunity to package these products and services as they see fit. The GLBA

and the evolving nature of financial services have also made it more and more difficult for financial institutions to determine what types of tying arrangements are permitted.

Along with the Board's proposed interpretation, other regulators and government agencies have made the tying issue a priority. On September 25, 2003, the Office of the Comptroller of the Currency ("OCC") released a white paper entitled, "Today's Credit Markets, Relationship Banking and Tying". The OCC paper reached the conclusion that "relationship banking is more likely the result of cost savings, not anticompetitive tying". In October 2003, the General Accounting Office ("GAO") is set to release a report regarding the tying practices by banks which will attempt to shed more light on this subject.

The Roundtable supports the Board's efforts to provide guidance in this area and the examples provided which demonstrate what types of conduct and arrangements are prohibited and are permissible under section 106. This guidance will assist financial institutions with their compliance under the Act. The Roundtable offers the following *recommendations* to the Board on how they could improve upon the proposed interpretation.

Banks Should Not be Held to a Stricter Standard under the Antitrust Laws

Commercial banks are required to adhere to a stricter standard than what exists in general antitrust laws (the Sherman and Clayton Acts) when it comes to tying arrangements. A typical federal antitrust illegal tying claim involves the showing of five elements. By contrast, there are only two elements needed to show that a tying arrangement violates 106: (1) The arrangement must involve two or more separate products; the customer's desired product(s) and the one or more separate tied product(s); and (2) The bank must force the customer to obtain (or provide) the tied product(s) from (or to) the bank or an affiliate in order to obtain the customer's desired product(s) from the bank.

This standard restricts commerce and limits a bank's ability to compete in the marketplace. Unlike other industries which are allowed to market more aggressively, and negotiate tying arrangements with customers, banks are restricted. The Roundtable *recommends* that the Board take these restrictions into consideration when creating their regulations and counter balance these laws with fair rules which will allow certain tying arrangements to take place while also protecting the rights of the consumer.

The Traditional Bank Product Exception is Too Narrow

The traditional bank product exemption allows banks to condition the purchase of any product on the purchase of a "traditional bank product". Through the

traditional bank product definition, the Board has the ability to determine what types of tying arrangements may be offered by institutions. The Board's proposed definition of traditional bank product includes cash management, trust services, custodial services, payroll services, settlement and wire transfer services, and discretionary asset management. The Roundtable believes that this is a good starting point, however additional products should be added to the list and, in some instances, the products listed require further clarification. The Roundtable offers the following *recommendations* on the definition of traditional bank products.

- The description of "trust service" should be expanded to include corporate trustees, fiduciaries under ERISA, mutual fund activities if the bank or an affiliate is the investment adviser to the mutual fund and other investment advisory activities including investment advice to individuals, whether the bank does or does not have investment discretion. Trust services should also include providing advice in connection with mergers, acquisitions, divestitures, joint ventures, leveraged buyouts, recapitalizations, capital structurings, financing transactions and similar transactions.

- The Board has asked for 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. The Roundtable supports inclusion of these products on the list of "traditional bank products" just as the Board has included credit derivatives. Credit derivatives are a more recent, natural extension of the interest rate and foreign exchange swaps as another means of managing credit exposure. There is no clear rationale for including credit derivatives as "traditional bank products" and excluding interest rate and foreign exchange derivative products as they are all products typically offered in connection with a loan to manage the risks associated with the loan.

  Interest rate swaps and other interest rate protection products are generally sold in tandem with credit products and provide a means by which both the customer and the bank can minimize their respective risks relating to the underlying transaction. The use of swaps often enables customers to effectively obtain credit products for which they may not otherwise be eligible, such as swapping on an underlying floating rate loan to convert it to a fixed rate loan. Recognizing that there is an element of credit risk in swap transactions, most financial institutions incorporate the proposed swap transaction into their credit analysis of the underlying loan. Swap transactions are often included in cross default provisions in credit documents, allowing for swap termination in the event of a default on another facility.

Allowing banks to require the use of an interest rate protection product as a condition to obtaining a loan would not, in and of itself, have an anticompetitive effect. Because a swap transaction derives its value from another, underlying transaction, in many cases, competing institutions will not find it desirable to engage in the swap transaction without having any of the risk inherent in the customer's other transactions.

- In July 2002, the Department of Housing and Urban Development ("HUD") proposed amending the Real Estate Settlement Procedures Act of 1974 ("RESPA"), Regulation X (24 CFR 3500) to allow guaranteed packages of settlement services and mortgages to be made available to consumers. The Guaranteed Mortgage Package Amendment ("GMPA") would include a guaranteed package price for a comprehensive package of loan origination and virtually all other settlement services required by the lender to close the mortgage (including without limitation, all application, origination and underwriting services, the appraisal, pest inspection, flood review, title services and insurance, and any other lender required services except hazard insurance, per diem interest, and escrow deposits); a mortgage loan with an interest rate guarantee; and a contract offer to guarantee the price for settlement services and the mortgage interest rate through settlement, if the offer is accepted by the borrower. Some of these services (such as appraisals, pest inspections, flood review, title services and title insurance) are not on the list of "traditional bank products" under the Board's proposed anti-tying interpretation. Therefore, a specific exemption may be desirable for a bank to offer a Guaranteed Mortgage Package that qualifies for the safe-harbor under Regulation X. Without an exemption, depository institutions and their affiliates will be at a competitive disadvantage to non-depository institution lenders. Furthermore, the benefits of the proposed change to Regulation X will be denied to a large segment of the public that relies on depository institutions for mortgage loans.

The Roundtable Opposes Certain Aspects of the Board's Interpretation of Mixed-Product Arrangements

A mixed-product arrangement involves a choice among traditional bank products and non-traditional products. The proposed interpretation states that "if the customer that is offered the mixed-product arrangement has a meaningful option to satisfy the bank's condition solely through the purchase of the traditional bank products included in the arrangement, then the bank's offer would not, in fact, require the customer to purchase any non-traditional product from the bank or its affiliates in violation of section 106." The Roundtable has the following *recommendations*.

1. The Board should allow mixed-product arrangements to be more freely offered to high net worth individuals and accredited investors.

The proposed interpretation assumes that "mixed-product" arrangements which include both traditional bank products and non-traditional products are not appropriate for individuals because they "have less bargaining power and may be less sophisticated and, would therefore, be susceptible to subtle pressure by the bank". The conclusion is that it would be difficult for a bank to establish a good faith belief that it has provided the individual customer with a meaningful choice. Read literally, the law seems to be protecting less efficient or less competitive providers of financial services.

The Roundtable believes that there are individuals who have the requisite sophistication and bargaining power to benefit from specific mixed-product arrangements. Private banking and other high net worth individuals frequently take it upon themselves to negotiate packages of services with financial institutions because bundling products is to their benefit. From the bank's perspective, Section 106 has never prohibited relationship banking. The Roundtable *recommends* that the Board amend its proposed interpretation to permit banks to offer varying mixed-product arrangements to high net worth individuals and accredited investors who understand the choices available and who can benefit from lifting the current restrictions.

2. Banking organizations should be allowed to offer bundled products at competitive prices.

The Board states that "the potential for subtle pressure to be applied in a manner that is both effective and difficult to uncover is particularly strong in mixed-product arrangement because the arrangement includes both traditional bank products and non-traditional bank products and individuals often believe that they do not have (and, in fact, may not have) the ability to negotiate with the bank." The Board admits this rule is restrictive by stating that, "the Board recognizes that section 106 limits the ability of banking organizations to provide individual consumers with discounts on packages of bundled products and, thus, pass along the cost savings that may arise from bundled offerings in ways that are both pro-consumer and not anti-competitive".

The Roundtable and its members share the Board's concern that consumers are not forced to take products they do not want. Customers (retail and business) should be able to make meaningful choices when deciding what packages of products and services they want to purchase. However, the Roundtable believes that there are mixed-product arrangements that offer meaningful choice to individuals and provide a valuable discount or increased return. For example, mixed-product

arrangements could be beneficial to consumers and offer "meaningful choice" if the products are otherwise offered separately at a reasonable or competitive price and the discount or increased return could also be obtained by purchasing traditional banking products or services. Offering such mixed-product pricing in a standardized, fully disclosed manner could in fact benefit the retail customer by providing them with product options and the information necessary to make informed decisions.

The Roundtable notes that previous meetings between regulators, the industry, trade associations, competitors of banks and members of the public focused primarily on relationship pricing for corporate customers. The Roundtable *recommends* that the Board clarify in their final interpretation that interested parties will be given a similar opportunity to be heard regarding the application of these rules to retail customers.

3. The Roundtable opposes reviewing mixed-product arrangements on a case by case basis.

The guidance suggests that the due diligence requirements involve a customer-by-customer, transaction-by-transaction review to determine if a mixed-product arrangement violates section 106. For example, the guidance requires bank policies, procedures and documentation "to reflect how the bank will and does establish a good faith belief that a customer offered a mixed-product arrangement would be able to satisfy the conditions associated with the arrangement solely through the purchase of traditional bank products." The guidance further requires bank policies to address factors and types of information that the bank will review for each individual customer to determine whether that customer has been afforded a meaningful choice to purchase only traditional bank products, including:

- The types and amounts of traditional bank products typically required or obtained by companies that are comparable in size, credit quality, and nature, scope and complexity of business operations to the customer; and

- Information provided by the customer concerning the types and amounts of traditional bank products needed or desired by the customer and the customer's ability to obtain those products from the bank or its affiliates.

The Roundtable believes that a bank offering mixed-product arrangements should not be required to analyze each customer's individual ability to make a meaningful choice among traditional and non-traditional bank products whenever the customer enters into a transaction with the bank. Section 106 does not list a

requirement to test permissible tying arrangements on a customer-by-customer basis, nor are we aware of any regulatory exception that requires such an analysis.

If a customer-by customer review is intended, legal and compliance staff would be required to review, either before the fact or at the time of execution of each transaction, each mixed-product arrangement entered into between the bank and a customer, despite the fact that legal and compliance staff had already worked with the business units to structure a mixed-product program that complied with section 106. This would have a chilling effect on the bank's ability to negotiate with customers because in doing so the bank could be viewed as imposing a requirement. In addition, this would require extremely burdensome recordkeeping in order to track information provided by the customer and to compare the individual customer to all other customers of comparable size and credit quality, and nature, scope and complexity of business in order to prove the customer was given a meaningful choice whether or not to enter into the mixed-product arrangement.

The Roundtable *recommends* that the Board reduce the burdens imposed by its supervisory guidance by clearly stating that it is sufficient to test mixed-product arrangements at the program level before they are offered to the bank's customer base. This will eliminate the need for extensive recordkeeping and other management and systems procedures which would be crippling for financial institutions who wish to enter into mixed-product arrangements with customers.

4. A technical and conforming amendment should be added to clarify that traditional bank products in a mixed-product arrangements include traditional bank products provided by bank affiliates.

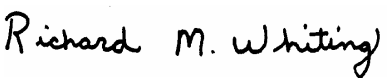
For purposes of clarity, the Roundtable *recommends* that the Board expressly state in the proposed rule that it would be permissible for the traditional bank product component of a mixed-product arrangement to involve traditional bank products provided by affiliates of banks, as well as by the banks themselves consistent with the Board's interpretation of section 106 under Regulation Y (12 CFR 225.7).

Conclusion

The Roundtable would like to thank the Board for considering the recommendations outlined above. We appreciate the Board addressing the important issue of tying, especially in light of the evolving competitive marketplace created by the GLBA. Our member companies look forward to collaborating with the Board's staff as you continue to update this interpretation and supervisory guidance.

If you have any further questions or comments on this matter, please do not hesitate to contact me or John Beccia at (202) 289-4322.

Sincerely,



Richard M. Whiting
Executive Director and General Counsel