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

Re: Proposed Interpretation and Supervisory Guidance Regarding the Anti-Tying Restrictions of Section 106 of the Bank Holding Company Act Amendments of 1970
Docket No. OP-1158

Dear Ms. Johnson:

U.S. Bancorp appreciates the opportunity to comment on the proposed interpretation and guidance regarding the anti-tying restrictions of Section 106 of the Bank Holding Company Act Amendments of 1970.

U.S. Bancorp is the eighth largest financial holding company in the United States with headquarters in Minneapolis, Minnesota, and offices in 24 states throughout the Midwest and West. Through U.S. Bank and other subsidiaries, U.S. Bancorp offers a comprehensive range of financial products to meet the needs of individuals, businesses, institutions and government entities. U.S. Bancorp's products cover a broad financial spectrum including electronic payment systems, investments, asset management, securities brokerage and corporate trust services.

We support the Board's efforts to provide guidance in the area of anti-tying and offer the following recommendations on the proposal.

Traditional Bank Products

The Board has proposed an expanded list of products that fall within the "traditional bank product" exemption of Section 106. U.S Bancorp supports the inclusion of an expanded list in the interpretation but recommends the following additions and clarifications:

1. **Interest Rate and Foreign Exchange Swaps.** 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. U.S. Bancorp 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 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 derivatives, as they are all products offered in connection with a loan to manage particular risks associated with that loan, and all have an inherent level of credit risk.

   Interest rate swaps and other interest rate or foreign exchange protection products are generally sold in tandem with credit products and provide a means by which both the customer and 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.

   U.S. Bank only recommends derivative transactions to customers for hedging purposes and only after a division of the bank, independent of the lending function, determines that the transaction is appropriate for the customer, based on criteria such as the customer's risk management goals, level of customer sophistication and understanding of derivative products, including the nature and risks involved with derivatives. The customer is also advised to seek tax, legal, and accounting guidance from its financial advisors.

   Derivative products are incorporated into the bank's analysis of the customer's creditworthiness and approved in accordance with the its credit policies. Derivatives are assigned a loan equivalent credit position, using formulas tailored to each product's features and volatility. The loan equivalent credit position is approved and tracked with the customer's total committed facilities as a "soft" exposure. Additionally, the bank sets aside reserves for each derivative position to protect against customer default.

   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 anti-competitive 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 a swap without being a party to the underlying transaction. Due to the credit risk inherent in swap transactions, they are often included in cross default provisions in loan

documents, allowing for swap termination in the event of default on another facility. Finally, a bank providing only an interest rate protection product to a customer is likely to charge higher fees because it is taking on additional risk without having any of the protection provided on the underlying loan, such as collateral.

2. **Merchant Processing.** The Board has included "payment and settlement services" on the list of traditional bank products. U.S. Bancorp requests that the Board clarify that "payment and settlement services" includes merchant processing services, just as it does other electronic-based payment and settlement services such as electronic fund transfers, electronic benefit transfers or smart cards.

   Merchant processing is the settlement of electronic payment transactions for merchants. The merchant or "acquiring" bank authorizes, clears and settles credit, debit or charge card transactions on behalf of its merchant customers. The acquiring bank enters into agreements with the merchants to provide authorization access to the issuers of credit, debit or charge cards so as to permit the merchant to validate that funds are available at the time a purchaser presents an approved card as means for payment to the merchant. The acquiring bank clears the transaction with the respective card association (or internally if it is a closed system) for financial settlement and then in turn pays the merchant for transactions the merchant presented to the bank, less fees called the discount rate. In essence, the acquiring bank finances the merchant's card accounts receivables. Merchant processing is a natural extension of more traditional forms of payment and settlement service with a credit underwriting and discount component.

Mixed-Product Arrangments

Under the Board's proposed interpretation a mixed-product arrangement which includes both traditional and non-traditional bank products does not violate Section 106 if the customer has a meaningful option to satisfy the bank's condition solely through the purchase of the traditional bank products included in the arrangement. U.S. Bancorp is concerned that the internal control and recordkeeping requirements related to mixed-product arrangements in the Board's proposed guidance are so burdensome that a bank would be effectively deterred from offering such arrangements.

The guidance requires a bank to maintain 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 then details various factors and types of information that the bank should review to determine whether a specific customer has been given a meaningful option to purchase only traditional bank products in the

mixed-product arrangement. The information outlined in the guidance includes the types of traditional bank products typically required by companies the size of the customer and the information provided by the customer concerning the types of traditional bank products it needs or desires. This suggests that the Board is requiring a case-by-case review and documentation that the review was performed for each customer.

U.S. Bancorp strongly urges the Board to clarify that a bank can satisfy the internal control requirements by reviewing its mixed-product arrangements within a specific business line before the arrangements are offered to customers and that customer-by-customer review is not required. There is no statutory or regulatory basis for requiring a bank to adopt an individualized compliance model in order to offer mixed-product arrangements to corporate customers. The case-by-case review suggested by the guidance would be more appropriate for consumer transactions, not for products that are only offered to businesses, which have a greater degree of bargaining power and sophistication. The Board has acknowledged that a "less detailed and granular review" would be required for a bank in dealing with a large, complex company or with an existing customer with a long relationship with the bank. U.S. Bancorp recommends that the guidance allow a bank to determine the level of review and internal controls required to ensure that its mixed-product arrangements do not result in illegal tying.

If you have any questions regarding these comments, please feel free to call the undersigned or Betsey Thompson, Vice President and Compliance Manager, 314-418-2493.

Sincerely,

Karen J. Canon
Vice President and Senior Corporate Counsel

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