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September 30, 2003

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

Attention: Docket No. OP-1158
regs.comments@federalreserve.gov

Re: Proposed Interpretation and Supervisory Guidance on Section 106 of the Bank Holding Company Act Amendments of 1970

Ladies and Gentlemen:

J.P. Morgan Chase & Co. ("JPMorgan") appreciates the opportunity to comment on the proposed interpretation and supervisory guidance on section 106 of the Bank Holding Company Act Amendments of 1970 (the "Proposal") issued by the Board of Governors of the Federal Reserve System (the "Board"). JPMorgan has participated in the preparation of the comment letters being submitted by the New York Clearing House Association L.L.C. (the "Clearing House"), Simpson Thacher & Bartlett and the ABA Securities Association ("ABASA"), and endorses their respective submissions.

JPMorgan greatly appreciates the Board's effort to provide clarity to an area that can easily be misunderstood. The banking industry has long known that section 106, like other antitrust statutes, may appear to state simple, clear rules, but in practical application is really quite complex, with many gray areas where lines must be drawn with little or no reliable guidance. In the wake of the expansion of powers granted to the banking industry, culminating with the passage of the Gramm-Leach-Bliley Act, many of these line-drawing exercises have not only lacked precision and predictability, but in fact have become increasingly counterintuitive, particularly in large commercial transactions. Banking organizations have been exposed to misunderstandings with commercial customers and the public at large, as well as to litigation and reputational risk, arising from what we believe are appropriate business dealings with sophisticated customers. The Proposal would help to clarify many of these situations.

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We do, however, have concerns that the current text of the Proposal would leave intact some gray areas, which would in some instances become even more difficult and counterintuitive as a result of the Proposal. As a practical matter, given the fact-intensive nature of the anti-tying rules, it is the business side of a banking organization that must frequently deal with these gray areas on a real-time basis in ordinary course discussions with their customers. The nuances of the anti-tying rules can convert these discussions into treble damage claims that, even if baseless, would be difficult to dismiss on a motion for summary judgment because of the fact-intensive nature of a dispute. We respectfully request that the Board consider the following comments and consider making modifications, and consider using its exemptive authority in some instances, to further reduce uncertainty in this complex area.

Declining Credit and Mixed-Product Arrangements

The Proposal begins its analysis of section 106 with the point that the statute "does not require a bank to extend credit or provide any other product to a customer." This is undoubtedly correct. Section 106 is derived from the general antitrust laws and was designed to prevent banks from engaging in certain practices that Congress considered to be anticompetitive; it did not convert banks into public utilities that must grant every requested loan in the absence of an identifiable credit issue.

Banks have always been permitted to consider a variety of factors besides the creditworthiness of an individual customer's request for a loan. For example, since each bank's capacity to lend is not unlimited, banks need to make rational business decisions as to how much exposure they wish to have in the consumer sector and in the wholesale commercial sector. Within the commercial sector, decisions need to be made as to concentration limits within industry groups and with respect to individual obligors, and between investment grade and non-investment grade customers. Not surprisingly, since banking organizations are publicly traded and are answerable to shareholders, decisions need to be made, within the confines of applicable law including section 106, as to how to manage the credit product to maintain profitability standards within the organization.

In making these decisions, banks are keenly aware that corporate customers value credit, and that providers of credit frequently are rewarded by such customers with ancillary business. This has always been true, even before the gradual demise of portions of the Glass-Steagall Act, when the ancillary business consisted primarily of so-called "traditional banking products." The practice of borrowers awarding ancillary business has grown as banking organizations have been empowered to offer a wider array of products and as borrowers have come to understand the power they can wield by selectively awarding that business to firms that will extend credit to them. In light of the value a customer places on its credit relationships and a banking organization's profitability concerns, banking organizations frequently consider the prospects of receiving other business when making decisions as to whether to extend credit, a practice that is generally known as "relationship banking." Financial deregulation has not discouraged banking organizations from engaging in this practice, and in fact has had the effect of encouraging banking organizations to seek synergies across the full range of their traditional and non-traditional product offerings.

In light of the foregoing, the ability of a banking organization to decline a loan or other product request that is not sufficiently profitable to the banking organization, taking into account ancillary business, is a most important point. After confirming that section 106 does not require a bank to provide credit or any other product, the Proposal goes on to state that this is only true "so long as the bank's decision is not based on the customer's failure to satisfy a condition or requirement prohibited by section 106." At least two significant issues concerning the scope of section 106 arise from this statement.

The first is whether a bank can violate section 106 without communicating and imposing a condition or requirement on the customer. This issue is addressed on page 12 of the Proposal, where it is made clear that section 106 is not violated unless there is some element of coercive behavior by the bank toward the customer. Consistent with this statement, a bank clearly may exercise its right not to make a loan and avoid liability under section 106 by not imposing a condition or requirement on the borrower. In order to avoid any uncertainty in the Proposal as to this point, we recommend that the Board modify the statement quoted in the preceding paragraph to read "so long as the bank's decision is not based on the customer's failure to satisfy a condition or requirement *imposed by the bank* which is prohibited by section 106." (Emphasis added). Section 106 does not prohibit the bank from declining to extend or participate in a loan due to profitability (or other) considerations if it has never imposed a condition on the customer.

A second issue arises naturally from the scenario described above. The customer would likely ask the bank's representative why the bank is not interested in making the loan, and would likely attempt to engage the banker in a discussion. In order to be responsive, the banker would want to tell the customer the simple truth that the bank generally is not interested in making loans unless its profitability concerns are met. Alternatively, the banker may wish to engage in a discussion with the customer to determine whether a relationship with the customer (or a continuing relationship, if it were an existing customer) would be or may become sufficiently profitable to the banking organization. In either case, the issue is whether, or at what point, revealing the banking organization's internal economic considerations to the customer would constitute an impermissible condition or requirement under section 106, because implicit in the banker's response is that its profitability requirements must be met as a condition to making the loan.

The Proposal's discussion of "mixed-product arrangements" beginning on page 18, together with the supervisory guidance beginning on page 27, appears to address this issue. Taken together, the interpretation and supervisory guidance suggest the principle that imposing a condition that a profitability hurdle must be met is permissible only if the bank has first established a good faith belief that the customer would be able to meet the hurdle using only "traditional bank products" offered by the bank. As a result, in the scenario described above the bank could violate section 106 by engaging in a dialogue if it had not first completed specific due diligence as to that customer. By discussing its profitability concerns, the bank may be deemed to have imposed a condition without having formed a good faith belief that the condition could reasonably be met with

traditional bank products. If it turned out that the profitability hurdle could be met, but only by using at least one non-traditional bank product, the bank would have violated section 106; according to the Proposal, if the customer does not have a "meaningful option" to meet the hurdle using only traditional bank products, "then the arrangement violates section 106 because the arrangement effectively requires the customer to purchase one or more non-traditional products in order to obtain the customer's desired product..." (At p. 19.) Presumably there would be no violation under the Proposal if it turned out that the customer could not meet the profitability hurdles using any combination of products and the bank exercises its right to decline the transaction.

In order to avoid falling into this dangerous territory, the Proposal would effectively require that the banker stop discussions with the potential customer until it could make a good faith determination of the customer's needs for traditional bank products. The Proposal sets forth due diligence guidance, which among other things requires that the banker ask the customer what its traditional bank product requirements are, and that the banker ascertain the customer's "ability to obtain" those products from the bank.

We believe that there are several issues with the mixed-product arrangement standards set forth in the Proposal. First, we concur with the positions expressed in the Clearing House and ABASA comment letters that the criteria set forth in the Proposal for due diligence to support the banking organization's "good faith" conclusion on a customer-by-customer basis create a substantial and burdensome compliance infrastructure that will apply to ordinary course discussions with customers. We believe that the customer-by-customer approach reflects an unduly rigid interpretation of section 106, given the starting point that the bank is not required to extend credit, or provide any other product, to every applicant.

Further, as a practical matter, the customer-by-customer analysis called for by the Proposal would put the banker in an unworkably awkward position in navigating the restrictions of section 106 and in taking into account the banking organization's profitability goals. Instead of pursuing a meaningful exploration of possible ways for the customer to meet profitability hurdles, the banker would have to ask the customer to provide comprehensive details about its financial services requirements and existing arrangements for those requirements, which the customer may not, to say the least, be inclined to provide. While pursuing this information, the banker must avoid crossing the line by imposing a condition on the customer. This would result in a very difficult dynamic, particularly when customers know exactly why banks are asking these questions. The very exercise of drawing such information out of the customer regarding its traditional bank product needs may lead the customer to allege that an illegal condition or requirement was imposed, explicitly or implicitly, on the customer. The process would require considerable dexterity on the part of the banker.

Even if a banker reaches the required good faith judgment before imposing a profitability condition on a customer, the subsequent discussion with the customer could prove the good faith judgment to have been wrong; it may turn out that the customer in

fact does not have sufficient traditional bank product business to meet the profitability hurdle. In this case, if the bank ultimately decides not to proceed to make the loan after having imposed a condition, it appears to be vulnerable to a private action by the disappointed customer, despite the bank's efforts.

As a separate matter, the customer-by-customer approach may have the adverse effect of inhibiting growth in profitability targets by tethering such targets to the returns derived from traditional banking products. Moving profitability hurdles higher, which a banking organization may wish to do for sound business reasons, obviously would increase the issues in mixed-product arrangements that must be analyzed on a customer-by-customer basis. In addition, the notion that banks can only include traditional bank products that the customer could "reasonably obtain" from the bank, or "legally transfer" to the bank, could result in even greater competition for these products among banks, and create incentives for banks to try to "lock up" that business to facilitate their mixed-product arrangement analysis for their customers. To the extent a bank is successful in doing so, it would become more difficult for the bank's competitors to meet the requirements of a mixed-product arrangement for that customer, thereby reducing options available to the customer.

We request that the Board consider modifying the "mixed-product arrangement" section of the Proposal in favor of a standard that would allow a banking organization to announce that it has general profitability constraints and goals, and that its customers or categories of its customers may be required to maintain an overall relationship with the banking organization that is profitable using any combination of products offered by the banking organization. We recognize that the Board is likely concerned that if banks are permitted to impose a general condition of profitability on its customers or categories of customers, the purpose of section 106 can be defeated for some customers by a banking organization's setting its profitability hurdles at levels that cannot be met unless those customers accept non-traditional bank products from the banking organization. However, we feel strongly that section 106 does not require that banking organizations be held responsible for whether or not each individual customer could meet that hurdle, so long as the banking organization makes all of its products available to all customers without discrimination. The Board could include as a part of its supervision of banking organizations a review of their programs for mixed product arrangements and could thereby assess whether those programs have been established and used in a reasonable manner or in an artificial manner that simply attempts to evade section 106. Any banking organization should be prepared to demonstrate generally that its hurdle rates applied to classes or types of its customers (not on a customer-by-customer basis) provide a "meaningful choice" to those categories of customers to meet the hurdle rates using the banking organization's available menu of traditional bank products. We believe that such an approach would be consistent with the statutory language, its purpose and the principle that banks are not required to make any particular loan.

If the Board determines that it is not prepared to modify its position on mixed-product arrangements, as an alternative we would request that the Board relieve banks from the diligence requirements, recordkeeping burdens and litigation risks arising from

such arrangements by permitting banks to assume that their large commercial customers would be able to meet the standard. This assumption would recognize that governmental entities and private sector entities that request loans in amounts above a certain threshold, for example, $50 million, typically do have needs for an array of traditional bank products that most likely would permit such entities to meet profitability thresholds using those products alone. Further, such entities are sophisticated and would likely be able to negotiate the credit and capital markets in order to obtain the financial products they seek from what is clearly a competitive marketplace of financial service providers. The Board recognized in the Proposal that large, complex companies would likely require a "less detailed and granular review" than smaller companies. Our request for an assumption in the case of large customers goes a step further, because we believe that even the lesser customer-by-customer standard of review proposed by the Board would be unduly burdensome and would subject banks to unnecessary litigation risk in the event of a dispute with such customers of substantial means. For the remaining population of commercial customers, we would request that the "good faith" analysis be on a customer-wide basis as opposed to a customer-by-customer basis.

These points are particularly important because profitability considerations will routinely figure into many lending decisions. We request that the Board consider the burden of increased litigation risk and compliance requirements with the benefit provided, particularly with regard to commercial customers of significant size. Such customers are sophisticated and quite capable of navigating the financial markets. It is worth noting that on the day after the Proposal was released, an article appeared on page one of The Wall Street Journal entitled "Companies Put a New Squeeze on Their Investment Banks", which reported how companies are requiring investment banks to purchase their products and services in order to qualify for consideration for the companies' capital markets mandates. Companies that have such business to distribute know that they have considerable leverage in awarding their financial services "wallet" to investment banks eager to provide those services. As stated in the article, "There is little doubt that Wall Street firms and their clients keep score on how business flows back and forth between them." Such companies are certainly likely to have meaningful choices among financial services providers.

Economic Power

We strongly support the positions expressed in the comment letter by Simpson Thacher & Bartlett arguing that economic power in the tying-product market should be a necessary element of a violation of section 106, despite the historical interpretation of section 106. To this we would add that the historical treatment of section 106, which assumes that each bank has market power over each and every one of its products, adds to the counterintuitive nature of the statute in light of today's highly competitive financial services marketplace. Section 106 has been interpreted as the only antitrust statute for which a determination of the existence of economic power is irrelevant. Bankers who frequently encounter demands from large commercial customers to provide credit as a condition to being considered for non-traditional bank product business find this concept

very difficult to understand. The idea that the banker always has leverage over its customer is far removed from reality.

Coercion

The Proposal is very helpful in acknowledging that customers may initiate ties, and that there is no violation of section 106 when this occurs. The Proposal also correctly states that in order for there to be a violation of section 106, a bank must force a condition upon the customer. We agree that this is the correct analysis, and concur with the Board's rejection of the flawed analysis of the Dibidale case.

However, we also believe that the Proposal unnecessarily leaves open to challenge other transactions that fall between the extremes of a blatant violation by a bank and a completely voluntary tie by a customer, because the Proposal is not clear as to what is meant by the "forcing" or "coercion" that is required for a violation.

For the reasons described in the Simpson Thacher & Bartlett comment letter, we believe the coercion required under section 106 must be the kind of coercion dictated by the general antitrust laws from which section 106 is derived, meaning coercion backed by the economic power to actually limit the customer's choice and reduce competition. If coercion instead were to mean any condition imposed by the bank, whether or not it has the power to force or coerce the customer to accept the condition, then this would mean that a bank could be liable, for example, for responding to a proposed voluntary tie by a customer with a counteroffer of its own. There would be no coercion in such a case, and the bank should not be deemed to have violated section 106. We believe the Board could remove a great deal of uncertainty in this area by very clearly confirming that it is "antitrust law coercion" that is required for a violation of section 106.

Voluntary Tying

We appreciate the Board's making clear that it is completely permissible for a customer to impose a tying condition on a bank. The Proposal notes specifically, for example, that it does not violate section 106 for a customer to demand that a bank provide a loan in order for the bank or its affiliates to obtain bond underwriting business.

Once the customer has imposed such a condition, we believe that a bank should be able to accept the condition and enforce it without concern that it could in turn be accused of having imposed an impermissible condition on the customer. Further, in recognition of the realities of business negotiations between sophisticated parties, a bank should be permitted to issue a counter-proposal to such a customer. Otherwise, a bank could only decline repeated offers in the hope that the customer eventually will submit a proposal that is appealing to the bank. Once the customer has opened the door by imposing a condition on the bank, the customer has signaled its status as a sophisticated company with financing options, and the bank should be able to negotiate without fear of being accused of violating section 106 by a customer which subsequently becomes disgruntled, typically because it is unable to repay its loans for unrelated reasons.

Two Products Requirement

The Proposal notes that there must be two products in order for a potential tying arrangement to exist. Footnote 23 states: "As a general matter, two products are separate and distinct for purposes of section 106 only if there is sufficient consumer demand for each of the products individually that it would be efficient for a firm to provide the two products separately." We believe that this standard is unduly rigid for purposes of section 106.

While we recognize that this standard is derived from the same general antitrust laws from which section 106 is derived, in this case it is important to recognize that section 106 is different from the general antitrust laws in at least one crucial respect. It is the only antitrust law that prohibits varying of consideration when two products are offered together (the Clayton Act prohibits varying a product's pricing on the condition that the customer not use another supplier). The Board recognizes this distinction on page 7 of the Proposal, where it notes that prohibitions of price discounts "are not included in the conventional notion of tying." In light of this provision of section 106, an interpretation of what constitutes a "single product" derived directly from antitrust law would call into question legitimate pricing variations and bundling of interrelated products that make sound economic sense and are not anticompetitive.

We recommend a standard that permits recognition of the interrelated nature of component products when the second component affects the pricing considerations for the first component due to credit or similar structural considerations. For example, a bank may offer a loan with an interest rate or equity derivative collar obtained from the bank at a different rate than it would offer the loan if the related derivative product were obtained from a third party, because the risk profile of the loan can change due to the nature of the borrower's derivative counterparty, as well as the presence of intercreditor issues if collateral must be shared with the third-party derivative counterparty. Not having to deal with the credit risk of another party and intercreditor issues has value to the bank, and the bank should be able to reflect that value by means of a discount in the price to the borrower. Furthermore, the bank should also be permitted to decline to offer the component parts separately. The separate, unbundled components would constitute a different product set than the integrated bundled components, which may result in a different credit and pricing analysis by the bank. Section 106 should not require an affirmative obligation on the part of the bank to undertake such an analysis.

This approach would be consistent in principle with the statutory exception for reciprocal arrangements, which acknowledges the validity of such arrangements when they are reasonably designed to protect the credit. In the same way that requiring collateral will lower the price of a loan, so could requiring that a related derivative purchased from the lending bank as opposed to from a third party affect the price of a loan. Loosening the standards for single products in this manner would encourage the development of integrated product offerings that would be beneficial for customers and banks.

Price Discounts

As mentioned above, section 106 is unique among antitrust laws in that it prohibits varying the consideration for two products offered simultaneously. This has long been a source of difficulty as it is counterintuitive that a price break for a customer would be problematic. Customers typically seek to obtain lower prices on packages of products. We appreciate the Board's acknowledgment in the Proposal that price discounts resulting from a customer's own use of bargaining power are not prohibited (p.16).

We question whether price discounts could ever be coercive. It never harms the customer to offer a discount on a product on the condition that another product is accepted, so long as the bank makes the discounted product available separately, at the full price. Discounting may give rise to concerns that prices could be manipulated so that the customer would have little incentive to purchase the separately available products. The Board addressed this same concern in its December 1994 amendment to Regulation Y, in which it permitted all discounts on products offered by nonbank subsidiaries of bank holding companies (which at the time were subject to section 106 pursuant to Regulation Y). The Board determined that the "separately available" requirement would be interpreted to mean "available at a price that would generally attract customers and therefore leaves customers desiring a product a meaningful choice between purchasing the product alone or through a package." 59 Fed. Reg. 65473, 65474). We request that the Board take the opportunity, either through interpretation or separate rulemaking, to extend the availability of pricing discounts to all products offered by banks, so long as they are offered separately in this manner. Discounts involving products of the bank and its holding company affiliate would of course continue to be subject to Section 23B of the Federal Reserve Act.

Traditional Bank Products

We agree with the positions stated in the Clearing House and ABASA comment letters that foreign exchange and derivatives should be added to the list of "traditional bank products" through the Board's exemptive authority. Congress contemplated that the banking services excepted from the restrictions of section 106 might include services that are not explicitly listed in the statute. We note that in commenting on the exemptive authority granted to the Board, the Senate Banking Committee stated in its report on the legislation that was enacted as section 106 that it expected the Board to use this exemptive authority to allow "appropriate traditional banking practices." Banks have long engaged in foreign exchange transactions as part of their fundamental business activities. Derivative products did not exist in 1970 when section 106 was enacted, and such products have become key components of banks' product offerings. Derivatives products are now as appropriate a banking practice as the loans from which such products were originally derived. Not considering these products as "traditional bank products" has become another counterintuitive aspect of section 106.

Additional support for including derivatives in the category of traditional banking products may be found in the determination made by Congress in section 206 of the Gramm-Leach-Bliley Act that "swaps" are "identified banking products." By so classifying swaps, a broadly defined term in that law, Congress made the determination that such products were so integral to the banking business that they could continue to be offered by a bank even if the bank did not register as a broker-dealer. Although we are not suggesting that Congress specifically considered this section 106 issue in enacting Title II of Gramm-Leach-Bliley, the policy issues are similar. Swaps have become so fundamental to the operation of banks that this business should for purposes of section 106 be accorded the same status as loans, discount, deposit and trust services.

Subsidiaries

The Proposal states in Section V that section 106 applies to most, but not all, subsidiaries of banks. We agree that this generally should be true because bank subsidiaries generally are permitted to engage only in activities that are permitted for the parent bank. One exception to this general rule, however, is Edge Act companies, which are permitted to engage in activities, such as limited amounts of securities underwriting, that are not permissible for banks or their operating subsidiaries. Edge Act companies, whether or not they are subsidiaries of banks, are expressly subject to section 106 pursuant to Section 4(h) of the Bank Holding Company Act. We believe the Board should except from the application of section 106 subsidiaries of Edge Act companies that are not engaged in banking in the United States, whether or not they are subsidiaries of banks.

Subsidiaries of Edge Act companies that do not take deposits in the United States and engage overseas in certain permitted securities activities certainly do not have market power and are not in a position to coerce a customer into taking products they do not want. Some of these companies engage in exactly the same activities in which their "section 20" securities affiliates are engaged in the United States. This can create ironic results, for example when such a foreign Edge Act affiliate enters into a mergers and acquisitions advisory engagement and would violate section 106 if it tied that service to another product with the customer, even though the same behavior would be permitted by its United States securities affiliate. Subsidiaries of Edge Act companies that are engaged in banking in the United States would remain subject to section 106 under the recommended approach.

JPMorgan appreciates this opportunity to comment on the Proposal, and would be pleased to discuss any of the points raised in this letter in more detail. Please contact the undersigned at (212) 270-5877 if you should have any questions.

Very truly yours,

Richard G. Jansen