INSTITUTE OF INTERNATIONAL BANKERS

299 PARK AVENUE, 17TH FLOOR, NEW YORK, N.Y. 10171
TELEPHONE: (212) 421-1611 FACSIMILE: (212) 421-1119
HTTP://WWW.IIB.ORG

LAWRENCE R. UHLICK
EXECUTIVE DIRECTOR AND GENERAL COUNSEL
DIRECT E-MAIL: LUHLICK@IIB.ORG

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VIA E-MAIL

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Ave., N.W.
Washington, D.C. 20551
regs.comments@federalreserve.gov

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

Ladies and Gentlemen:

The Institute of International Bankers (the "Institute") appreciates this opportunity to comment on the proposal of the Board of Governors of the Federal Reserve System (the "Board") to adopt an interpretation of the anti-tying restrictions of Section 106 of the Bank Holding Company Act Amendments of 1970 ("Section 106") and related supervisory guidance.

The Institute strongly supports the Board's issuance of interpretive and supervisory guidance in this area. Section 106 presents significant compliance challenges for U.S. banking institutions, including the U.S. banking operations of international banks. These challenges stem in part from the fact that the prohibitions of Section 106 are more rigorous than those of the generally applicable U.S. antitrust laws that apply to non-bank entities. In addition, the limited number of relevant judicial interpretations have not produced a coherent set of interpretations of Section 106 that can readily be adapted to a bank's day-to-day business operations. The Board is statutorily responsible for and well suited to the task of developing guidance under Section 106 that takes into account evolving banking practices, safety and soundness considerations and the interests of consumers of banking products and services. The Institute therefore supports the Board's efforts to clarify the many important issues addressed in its proposal.

Relationship Banking

The Institute supports the Board's clear recognition of the validity of "relationship banking" under Section 106, including the use of internal "hurdle rates" and other common banking practices that are both safe and sound and consistent with mutually beneficial customer relationships. The Board's proposed interpretation would provide that a mixed-product arrangement does not involve an impermissible tie under Section 106 if the bank can make a good faith judgment that its customer would have a "meaningful option" to satisfy the bank's hurdle rates through the purchase or pricing of one or more traditional bank products. While we understand the rationale for this approach, the Institute urges the Board to take into consideration the risk that such an approach may result in adverse effects on the competitive position of international banks and smaller U.S. domestic banks in the U.S. credit markets. In comparison to the largest U.S. money center banks, most international banks and smaller U.S. domestic banks offer a narrower range of traditional bank products because they lack the necessary infrastructure and economies of scale to compete with the largest domestic banks (and indeed international banks are subject to legal restrictions on their ability to offer retail deposit products). For example, international banks operating in the United States generally will not be able to look to such traditional bank products as cash management and custody operations as a source of profitability sufficient to meet customers' hurdle rates, if indeed they even offer those products in the United States.

The Institute urges the Board to consider the competitive position of international banks and smaller U.S. banks in crafting its approach to mixed-product arrangements. Having recognized the legitimacy of relationship banking, the Board should not implement Section 106 in a way that denies the benefits of relationship banking to certain classes of institutions (and their customers). In this regard, the Institute would offer the following observations and suggestions to mitigate, to the extent possible, the risk that international banks and smaller U.S. banks will be put at a competitive disadvantage vis-à-vis their major domestic competitors:

First, the Institute strongly supports proposals such as those made by the Association of the Bar of the City of New York to define an exemption from Section 106 for wholesale banking arrangements. The Institute believes that a compelling case has been made for exempting wholesale customers and/or transactions from the restrictions of Section 106 generally. However, as part of the Board's pending rulemaking process relating to its proposed interpretation and supervisory guidance, the Board could, as an initial matter, incorporate a wholesale exception as part of the Board's mixed-product approach—i.e., as a modification to the "meaningful option" test for large borrowers. For example, large borrowers could be exempted from the meaningful option test.

Such a wholesale exception would be especially important for branches and agencies of international banks, which compete primarily in wholesale lending markets and deal mainly with large, sophisticated borrowers. Whether such an exemption is defined in terms that relate to the size and sophistication of the customer (measured by, for example, sales, number of employees, or asset size) or the size of the transaction, the Institute believes that this would significantly alleviate the distortions that Section 106 creates in the wholesale banking markets and mitigate the risk that a mixed-product

approach will put international banks and smaller U.S. banks at a competitive disadvantage.

Second, in developing supervisory standards to be used to evaluate a bank's good faith judgments regarding its customers' options to purchase traditional bank products, the Board should incorporate sufficient flexibility to accommodate the variety of legitimate business practices and product offerings by different types of banking institutions. Flexible standards are important for all mixed-product arrangements, but they would be especially important to the extent the Board does not adopt the exemption advocated above for wholesale transactions and/or customers.

Thus, for example, the Institute supports the indication in the Board's proposed supervisory guidance that a bank should be able to make good faith judgments regarding mixed-product arrangements either for individual customers or for classes of customers. Particularly in the wholesale markets in which international banks compete in the United States, there are many areas in which good faith judgments based on classes of customers should be appropriate. Because there are places in the Board's proposed interpretation where the language could be read to require a customer-by-customer analysis to support a mixed-product arrangement, the Institute would suggest that the Board clarify the language of the final interpretation to make clear that class-based assessments are, under appropriate circumstances, an acceptable means to validate a mixed-product arrangement.

Similarly, the Institute supports the basic premise reflected in the Board's proposed interpretation that a single traditional bank product included in a mixed-product arrangement may be sufficient to meet the Board's "meaningful option" standard articulated in the proposed interpretation. Although the Board's hypothetical example in the proposed interpretation of a permissible mixed-product arrangement refers to a case in which the bank offers a variety of different traditional bank products, the Institute understands that the product offering for any particular institution in any particular mixed-product arrangement may (and necessarily will) vary.

Third, the Institute would suggest that the final interpretation expressly provide that the traditional bank products offered in a mixed-product arrangement may be provided by affiliates. In the case of international banks, the international bank would be permitted to include the products and services of its head office and all of its branches, as well as its U.S. and non-U.S. affiliates. While this point is apparent when the Board's analysis of mixed-product arrangements in the proposed interpretation is combined with the Board's previous extension in Regulation Y of the traditional bank products exception to include products offered by affiliates,[1] the Institute believes such a clarification would be a useful addition to the Board's interpretation.

Fourth, the Institute supports the Board's realistic and contextual approach to determining the evolving scope of the traditional bank products exception under Section 106. The Board's non-exclusive list of examples of products and services that qualify for the traditional bank products exception takes into account comparability (including functional equivalence) and relatedness to determine whether a particular

[1] See 12 C.F.R. § 225.7(b)(1).

product or service falls within the scope of the "loan, discount, deposit or trust service" exception. (For example, the Board's list of traditional bank products includes (1) leases that are functionally equivalent to an extension of credit and (2) cash management services, which are commonly provided in connection with a deposit account.) The Board's illustrative list of traditional bank products will assist international banks in reaching their own determinations whether a particular product or service is within the scope of the exception.

Of the traditional bank products not specifically included in the Board's list, the Institute would suggest that foreign exchange services (which banks frequently provide as an adjunct to deposit accounts and extensions of credit) and derivatives be included in the final interpretation. In the Institute's view, the power of a bank to enter into derivatives transactions of all types—whether interest rate-, currency-, credit-, equity-, commodity- or energy-related—derives from, and represents a logical outgrowth of, a bank's power to act as a credit intermediary. Many derivatives (e.g., interest rate swaps and currency swaps) are commonly provided in connection with loan products to hedge the relevant risk to the customer (and thus to protect the lending bank) and therefore may be considered within the scope of the traditional bank products exception. More broadly, however, the variety of derivatives that banks use today (and that did not exist in 1970) fall squarely within the realm of core banking products and should be treated as traditional banking products for purposes of the exception.

Whether the Board determines to clarify in the final interpretation that foreign exchange and derivatives may be treated as traditional bank products or to exercise its exemptive authority to extend the traditional bank products exception to include such products, the Institute believes that a clarification of this issue will assist international banks in their development of current policies and procedures to ensure compliance with Section 106.

In addition, the Institute notes that the Board's proposal seeks comment on the question of how derivatives sold by banks in connection with lending transactions should be treated under Section 106. The Board's question appears in the context of Part III.A of the Board's proposed interpretation, which describes the requirement that an arrangement involve two distinct products (as opposed to two aspects of a single product) in order to give rise to a potentially impermissible tie. In this regard, although it may not be necessary to clarify that such derivative products are one aspect of a single product when provided in conjunction with a loan (so long as the Board agrees with the conclusion that derivatives qualify as traditional bank products), the Institute agrees with such an analysis and would encourage the Board to include that conclusion in its interpretation.

The Role of Market Power

The Institute supports the Board's clear emphasis in its proposal on the fact that a violation of Section 106 may occur only when customer is forced or coerced to obtain an additional product (other than a traditional bank product) from the bank or its affiliate as a condition to the provision or pricing of a desired product or service. The Board's proposal thus

clarifies that cross-marketing, cross-selling and customer-initiated (or voluntary) ties are all fully consistent with Section 106.

In this regard, the Institute supports suggestions made in other comments regarding the relevance of market power to the Board's interpretation of Section 106. Recognizing that there exist certain inconsistencies in the legislative history and judicial interpretations of Section 106 regarding the role of market power in defining a violation of Section 106, the Institute believes that there is an overwhelming policy justification for limiting Section 106 to arrangements in which a bank leverages its market power to force or coerce a customer to obtain an additional product or service. In the Institute's view, this policy rationale is nowhere clearer than in the wholesale markets in which international banks compete. It is for this reason that, as noted above, the Institute strongly supports the development of a general wholesale exemption from the restrictions of Section 106 (as well as the more tailored modification to the Board's analysis of mixed-product arrangements described above). In addition, and more broadly, the Institute encourages the Board to continue to consider ways in which the economic realities of the U.S. banking markets, and the absence of leveragable market power in U.S. credit markets, should inform the Board's interpretation of, and exercise of exemptive authority under, Section 106.

Territoriality of Section 106

Lastly, the Institute appreciates the clear statement in the Board's proposal that Section 106 applies only to the U.S. branches, agencies and commercial lending company subsidiaries of international banks The Board's statement is consistent not only with the relevant statutory language of the International Banking Act of 1978, as amended, but also with Board's territorial application of other statutory provisions, such as Sections 23A and 23B of the Federal Reserve Act.

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Please contact the Institute if we can provide additional information or assistance.

Sincerely,

Lawrence R. Uhlick

Lawrence R. Uhlick
Executive Director and
General Counsel