

VIA E-MAIL AND OVERNIGHT EXPRESS

September 30, 2003

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

RE: Docket No. OP-1158

Dear Ms. Johnson:

Bank of America is pleased to provide its comments on the Federal Reserve Board's proposed interpretation of the anti-tying restrictions of section 106 of the Bank Holding Company Act Amendments of 1970 ("section 106"). Bank of America, with \$769 billion in total assets, is the sole shareholder of Bank of America, N.A., the largest bank in the United States, with full-service consumer and commercial operations in 21 states and the District of Columbia. Bank of America provides financial products and services to two million businesses as well as one out of three households within its franchise, and provides international corporate financial services for clients around the world.

Although the language of section 106 appears straightforward, it is in fact a very complex statute that has been subject to varied interpretations and uncertainties since its enactment in 1970. We appreciate the Board's efforts to bring a measure of clarity to its application. There are, however, a number of areas that Bank of America believes would benefit from further clarification.

This letter is divided into five parts. Part I discusses the Board's proposed interpretation regarding the applicability of section 106 to "relationship banking" and mixed-product arrangements. Part II discusses the need for and what constitutes "coercion" as a necessary prerequisite for a violation of section 106. Part III discusses the proposed interpretation's applicability to voluntary tying. Part IV addresses the Board's specific question with regard to derivatives that form part of a specific lending transaction. And Part V comments on the proposed listing of "traditional banking products". (References to page numbers in this letter are to page numbers in the Board's draft proposed interpretation and supervisory guidelines, Docket No. OP-1158, August 25, 2003).

I. RELATIONSHIP BANKING AND MIXED-PRODUCT ARRANGEMENTS

Relationship banking arises when a bank establishes internally set profitability standards (“hurdle rates”) for individual customer relationships to rationalize the efficient use of its capital. There are many banking products that, while priced at market levels, are not sufficiently profitable on a stand-alone basis in some instances to reach a bank’s hurdle rate. As a result, the bank will monitor the customer relationship to determine whether the customer makes use of other products and services that will result in the overall customer relationship meeting the hurdle rate. If the hurdle rate is not met over a period of time, the bank may eventually determine that its shareholders are better served by reallocating its resources to more profitable customer relationships.

We appreciate the Board’s efforts to rationalize the proscriptions of section 106 in the context of relationship banking. We recognize it is a difficult issue, and we particularly endorse the Board’s statement that:

“(S)ection 106 does not require a bank to extend credit or provide any other product to any customer.” (Page 7)

Nevertheless, we strongly believe this fundamental principle needs to be reiterated and underscored in the interpretation, particularly in light of subsequent language in the interpretation and the discussion of relationship banking, referred to in the interpretation as “mixed-product arrangements”. The discussions have the potential of nullifying the fundamental principle that banks are not required to extend credit or provide any product to customers.

Under the draft interpretation, mixed-product arrangements are those in which a bank, in conditioning the grant of a loan to a customer on a requirement that the customer obtain one or more traditional bank products, offers the customer the option of satisfying the requirement through the purchase of one or more traditional bank products or non-traditional bank products. In some circumstances, the requirement may be necessary for the customer relationship to meet a bank’s hurdle rate. The proposed interpretation states that such arrangements are only permissible if the customer has the capacity to meet the hurdle rate solely by purchasing traditional bank products. In the words of the proposed interpretation, such a customer would have a “meaningful option” (Page 19) to meet the hurdle rate by purchasing only traditional bank products. However, if the customer’s ability to purchase only traditional bank products was insufficient to meet the hurdle rate, then the interpretation states that the “bank’s actions would violate section 106” because the customer “would not have a meaningful option to satisfy the hurdle rate solely through the purchase of one or more of the traditional bank products” that are offered by a bank or its affiliates. (Page 20)

In other words, as the interpretation is currently drafted, if a bank tells a customer that its current business does not meet internal hurdle rates for the extension or renewal of a loan and that more

business is necessary to do so, and in subsequent discussions between the bank and the customer it is discovered that the customer's full utilization of the bank's traditional banking products would be insufficient to meet the thresholds, the bank would then not be able to decline the loan or renewal request for any reason without risk of violating section 106. In addition, the same result could occur in a bank's early discussions of a new or potential relationship with a new customer, before the bank has decided whether to extend credit and before the bank has learned whether the customer's ability to use traditional bank products could possibly meet the bank's hurdle rates. Under the proposed interpretation, a bank that engages in this discussion and learns that the customer's traditional product business could *not* meet the bank's hurdle rates, would then be forced to provide requested credit to the customer. This result is extreme and clearly not intended by section 106. Yet the result would be the logical outcome of the interpretation as currently drafted.

Furthermore, immediately following the statement of the fundamental principle that section 106 does not require a bank to extend credit or provide any other product to any customer, the proposed interpretation states "section 106 does not prohibit a bank from declining to provide credit or any other product to a customer *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.*" (Page 7, emphasis supplied). Thus, even if a bank does not discuss its relationship with a customer, the interpretation implies that a strictly internal decision by a bank not to extend or renew credit would be a violation of section 106 if it is based on the fact that the customer did not have the ability to meet the bank's hurdle rate solely through the purchase of traditional bank products, and notwithstanding that the reason for the decline was never communicated to the customer.

We do not believe any of the results described above are required by the language of section 106, by the legislative history of section 106, or by any judicial or regulatory precedent under section 106. Therefore, we are concerned that the proposed interpretation would result in examiners and others questioning virtually every multiple purchase made by a customer where one of the products is a non-traditional bank product, as well as virtually every decision not to extend or renew credit.

We are also concerned that the effect of this interpretation would be increased credit costs or decreased credit availability for customers that are unable to meet hurdle rates solely through the purchase of traditional bank products as well as for customers who do not have significant banking needs beyond credit. (This would put many banks in a very difficult position, pressuring them to raise credit costs for such customers and yet finding it difficult to do so as they respond to requested pricing on widely syndicated corporate loans – since most of these loans are syndicated to the market.)¹ It would also increase credit costs across the board to

¹ This could well have the unintended and irrational effect of raising the costs of bank credit for those customers who use other traditional bank products, but not in sufficient amounts to meet most commercial banks' hurdle rates. This effect could split the commercial/corporate syndicated loan market along such lines, with prices being raised and/or credit being squeezed for this market.

compensate banks for the risk of even discussing “meaningful options” with a customer where the bank did not have sufficient independent knowledge of the customer’s ability to meet a hurdle rate prior to any discussions with that customer. It would ultimately lead banks either to abandon the utilization of internal profitability targets, or, in order to avoid the risk of violating section 106, to feel compelled to extend credit in circumstances where it otherwise would not under any circumstance because of information received during discussions with the customer.

Furthermore, the proposed interpretation calls into question a bank’s ability to charge rates that may be in excess of its hurdle rates regardless of a customer’s ability to meet the bank’s hurdle rate through the purchase of traditional bank products. We strongly encourage the Board to affirmatively state that a loan or renewal can be extended at an interest rate that equals or exceeds the bank’s hurdle rate without regard to a customer’s inability to meet the hurdle rate solely through the purchase of traditional bank products.

A broad application of the proposed interpretation as currently drafted also greatly increases the risk of litigation associated with section 106. It subjects a bank’s determinations not to make or renew loans to second-guessing not only by examiners but also by customers. A customer could use its alleged inability to meet the bank’s hurdle rate solely through the purchase of traditional bank products (the “meaningful option” standard) as a method of intimidating a bank into making or renewing a loan or consenting to the extension of an amortization schedule. A customer who is denied a loan or renewal could litigate, with the hope of treble damages, over a bank’s failure to approve a request. If the bank is judged to have acted (or not acted in the case of a loan maturity) as a result of an impermissible desire to exit an unprofitable relationship of a customer that cannot satisfy the bank’s hurdle rate solely through the purchase of traditional bank products, the bank could be liable.

The proposed supervisory guidance would also impose significant new compliance obligations. The supervisory guidance in Part VII of the proposed interpretation states:

“(T)he bank’s policies, procedures and documentation generally should address...The internal processes and controls, including approval and documentation requirements, the bank uses to ensure that the [meaningful option analysis] is (i) performed by the bank for a customer before the customer is offered a mixed-product arrangement and (ii) adequately reflected in the records of the bank.” (Page 28)

It goes on to state:

“(T)he assessment of a customer’s ability to satisfy the condition associated with a mixed-product arrangement solely through the purchase of traditional bank products is made prior to, and reasonably current with, the time the arrangement is offered to the customer.” (Page 29)

Thus, it is clear that the Board intends that banks implement the “meaningful option” analysis on an individual-customer basis. The creation and maintenance of the infrastructure capable of doing so will be extremely burdensome and costly. Banks will be compelled to create tools to extract from individual customers their traditional bank product needs and the fees paid for them, regardless of whether the products are currently provided by the bank or its competitors. The systems would have to be capable of aggregating the raw data of a theoretical revenue stream arising from each customer’s need for and use of traditional bank products and measure it against the customer’s credit needs and the banks’ hurdle rate. The system would also have to be capable of determining whether such traditional bank product business is “legally available” to be switched to the bank. Furthermore, the information would have to be updated frequently, since the information would become relevant at loan origination, every loan amendment and loan renewal, whenever product sales occur, and, indeed, at every occasion where conversations with a customer relating to relationship profitability occur.

We recognize that the Board attempted to ameliorate this cost by stating that a “less detailed and granular review likely would be required for a bank to establish a good faith belief that a large, complex company has a meaningful option of satisfying a condition solely through the purchase of traditional bank products than a smaller company with less complex business operations.” (Page 29) Nevertheless, any bank that desires to drive customer relationships to attain hurdle rates will be required to create the expensive infrastructure from scratch.

If the Board insists on such a customer-by-customer analysis, we strongly urge the Board to consider creating a safe harbor for sophisticated customers meeting certain qualifications (e.g., customers meeting criteria based on market size; customers that are “qualified investors” as defined in section 3(a)(54) of the Securities Act of 1934 (15 USC 78c(54) as added by the Gramm-Leach-Bliley Act of 1999; or other tests demonstrating the likely sophistication of a customer and inability of a bank to force the customer to purchase non-traditional banking products). Such a safe harbor would create a presumption that the customer has the capacity to meet hurdle rates through the purchase of traditional bank products.

II. COERCION

The proposed interpretation appears to take the position that section 106 adopted a stricter standard on tying arrangements by banks than that which is applicable under the general antitrust laws. We believe that conclusion is open to substantial debate, and concur with the positions set forth in the letter and attachments to the Board from John L. Walker of Simpson Thatcher & Bartlett dated September 30, 2003, written on behalf of a group of financial holding companies and commenting on the proposed interpretation (the “Walker paper”). Nevertheless, while we do not agree that the general antitrust laws were usurped by section 106, we wholeheartedly agree with the basic premise reiterated throughout the proposed interpretation that coercion is a *sine qua non* of an anti-tying violation under section 106.

Like section 1 of the Sherman Act and section 3 of the Clayton Act, the language of section 106 is broad, general, and sweeping. And, just as in the case of section 1 of the Sherman Act and section 3 of the Clayton Act, which the courts have not read literally, a literal interpretation of section 106 would outlaw virtually every contract entered into by a bank. Any contract at its core is nothing more than mutually agreed upon conditions and requirements binding two parties to perform. And the mere presence of conditions or requirements in contracts cannot be the basis or even the inference of a violation of section 106.

The proposed interpretation seemingly acknowledges this point. It repeatedly states that to violate section 106, a bank must “force the customer to obtain...the tied product” (Page 9); “section 106 applies only to tying arrangements that are imposed by a bank” (Page 7); “section 106 prohibits a bank from imposing a condition on a prospective customer” (Page 6); “a violation of section 106 may occur only if the condition or requirement was imposed or forced on a customer by the bank” (Page 14); “the better interpretation of section 106 is that a violation may exist only if a bank forces or coerces a customer to obtain (or provide) the tied product” (footnote 36 at page 15). The legislative history of section 106 concurs with the conclusion that section 106 was intended to apply only to coercive ties.² Additionally, in a paper issued last week, the Office of the Comptroller of the Currency stated that in enacting section 106, “A primary concern of Congress was to prevent banks from using economic power to engage in *coercive ties*.” (Office of the Comptroller of the Currency, International and Economic Affairs Department and Law Department, Today’s Credit Markets, Relationship Banking, and Tying (September, 2003) (Emphasis in original)) (the “OCC White Paper”). We concur with all of the above conclusions.

It is axiomatic that, for a seller to be able to force a buyer, or to coerce a buyer, or to impose a condition or requirement on a buyer, the seller must have some form of power over the buyer. It is not sufficient simply to infer from the presence of conditions or requirements in a contract (in essence to infer from the mere existence of the contract itself), that a coercive tie has occurred. Unfortunately, the proposed interpretation fails to explicate what constitutes “coercion”. Indeed, the basic element that the general antitrust laws recognize as conferring coercive power over a buyer, i.e., economic power, is dismissed in the proposed interpretation in a footnote. (See footnote 21 at page 10). For the reasons set forth in the Walker paper and the OCC White Paper, we urge the Board to acknowledge in the interpretation the need for economic power as the coercive element necessary for a violation of section 106. At the very least, we recommend that if the Board is unable to define the elements of coercive power, a necessary element for a violation of section 106, it should at a minimum delete footnote 21 and not dismiss out of hand

² See, e.g., 116 Cong. Reg. S15709 (letter dated Sept. 14, 1970 from Federal Reserve Board Chairman Arthur Burns to the Chairman of the Senate Committee on Banking and Currency) (the bank tie-in provision of H.R. 6778 [the House version containing the anti-tying provision], “as reported [to the Senate], would prohibit coercive tie-ins . . .”); Conf. Rep. No. 91-1747 (1970), at 18 (“Section 106 of the bill, which has come to be known as the anti-tie-in section, will largely prevent coercive tie-ins . . .”).

the possibility that Congress did in fact intend section 106 to be interpreted in line with the principles of general antitrust law.

III. VOLUNTARY TYING

We appreciate the Board's recognition that section 106 does not prohibit customers from voluntarily seeking and obtaining multiple products from a bank and its affiliates. We also appreciate the position that "Cross marketing and cross-selling activities, whether suggestive or aggressive, are part of the nature of ordinary business dealings and do not, in and of themselves, represent a violation of section 106." (Page 13)

While we have long believed this to be the case, it carries with it problems similar to that discussed above with regard to coercion. That is, what documentation must be maintained by a bank to demonstrate that a condition or requirement contained in a contract was in fact sought by the customer? For example, immediately after stating that even aggressive cross marketing and cross-selling activities do not constitute a violation of section 106, the proposed interpretation asserts: "(B)ank actions that go beyond cross-marketing or cross-selling and that indicate that the bank will not provide the customer the desired product unless the customer obtains (or provides) another product from (or to) the bank or an affiliate do raise issues under section 106." (Pages 13-14)

That statement stems from the seeming presumption applied by the Board that all conditions or requirements contained in bank contracts are coercive unless proved otherwise. For example, in discussing the "voluntariness" of a voluntary tie, the proposed interpretation states: "The terms of the bank's offer to the customer or the agreement entered into between the bank and the customer will provide the best evidence of whether the customer was required to purchase (or provide) an additional product as a condition of obtaining the customer's desired product." (Page 15). In reality, the terms of the bank's offer or the agreement entered into between the bank and the customer is usually the embodiment of agreements reached through mutual negotiation. To infer otherwise is to infer from the mere existence of the contract itself that a coercive tie has occurred.

Without requiring more than the mere presence of contractual conditions or requirements, banks will be subject to much second guessing by examiners and others, including litigants, and placed in the position of having to prove their "innocence" on every contract. Furthermore, such a presumption places banks in an almost impossible position when it comes to establishing compliance standards for its banking officers. We believe those results can be ameliorated by a clear and positive statement in the interpretation that the mere presence of conditions or requirements in a contract does not, by itself, indicate a violation of section 106, and independent, substantive evidence of coercion must be present to constitute a violation.

IV. DERIVATIVES CONNECTED WITH LENDING TRANSACTIONS

The Board noted in the proposed interpretation that certain types of derivative products, such as interest rate and foreign exchange swaps, often are sold by banks and purchased by customers in connection with lending transactions. The Board requested comment on how interest rate swaps, foreign exchange swaps, and other derivative products that often are connected within lending transactions should be treated under section 106.

Where derivative transactions are deemed necessary to protect either or both the borrower and the lender, they should be viewed as necessary components of a particular lending transaction that are part and parcel of the lending transaction itself, and not as two separate products. The Board asserts in footnote 23, that 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. It is difficult to argue that an individually negotiated derivative contract structured to provide borrower and/or lender protection on a specific loan or on collateral for a specific loan does not meet that criteria. In that respect, derivative contracts connected to specific lending transactions are analogous to a customer purchasing from an auto dealer an automobile with tires attached. While it is possible to purchase the auto and tires separately, it is not efficient for the dealer to provide them both separately, nor does it make economic sense from the standpoint of the buyer.

Additionally, from a broader perspective, we believe that derivative transactions should be viewed as traditional banking products in the first instance, and therefore subject to the so-called “traditional banking product” exception of section 106. (See discussion below.)

V. TRADITIONAL BANKING PRODUCTS

We appreciate the Board’s efforts in Part IV of the proposed interpretation to set forth a non-exclusive list of products and services that fall within the “traditional bank product” exception of section 106. We believe there are a number of additional products and services, as well as some expansion of those listed in the proposed interpretation, that fall within the concept of a “loan, discount, deposit, or trust service”, and we discuss each below.

A. Derivatives

The only derivative transactions listed by the Board in the proposed interpretation are credit derivatives where the bank or an affiliate is the seller of credit protection. As noted above, however, we believe the full range of derivative transactions should be treated as traditional bank products, and not just credit derivatives where the bank or an affiliate is the seller of credit protection. The concept of financial intermediation embodied in derivative transactions covers a

broad range of payment, deposit, and loan services, and is not limited solely to a bank acting as seller of credit protection.

Derivative contracts involve exchanges of payments akin to those that a bank makes and receives in connection with its role as a financial intermediary. Although derivatives are not themselves loans or deposits, they are loan and deposit services. It is through a derivatives business, that a bank may engage in a modern form of the traditional financial intermediation functions that banks have always performed in providing payment, loan, and deposit services. In conducting a derivatives business, a bank makes payments to, or receives payments from, customers who want to manage financial risks resulting from the variations in interest rates or prices of designated reference assets or other indices. Customers do not deal directly with one another in these transactions, but instead make payments to or receive payments from an intermediary bank. Thus, a customer-driven derivatives business is a modern form of traditional bank financial intermediation activities involving exchanges of payments with a bank acting as an intermediary between customers.

B. Foreign Exchange Transactions

Foreign exchange transactions are the various transactions involved in the purchase and sale of currencies, an activity banks have historically engaged in within their deposit taking powers. Banks' customers utilize foreign exchange transactions primarily as a means for hedging foreign exchange exposure incurred as a result of their overseas operations and as a mechanism to facilitate payments offshore. Whether spot, forward, swap, or options transactions, they are classically deposit-like in their characteristics and involve the full range of deposit taking, payment and settlement service, and cash management products, which are themselves "traditional bank products" under the proposed interpretation.

C. Trust Services

The proposed interpretation notes that section 106 specifically defines "trust service" to mean "any service customarily performed by a bank trust department", and it acknowledges that a product that meets this "trust service" standard is a traditional bank product even if the bank or affiliate providing the product does not have, or does not provide the product through, a trust department. It lists a limited number of services/products as that have traditionally been performed by bank trust departments.

It is important to note that the statutory definition is not limited to fiduciary services performed in bank trust departments, but rather to any services customarily performed by bank trust departments, whether or not fiduciary in nature.

We believe that the full range of investment advisory and management services and pension fund management services falls within that language. Indeed, the OCC has long taken the position

Ms. Jennifer J. Johnson
September 30, 2003
Page 10

that general investment advisory and management services and pension fund services are “traditional trust services”. (See OCC’s Report of Operations, Corporate Policy and Economic Analysis, March, 1993; 1993 OCC QJ LEXIS 6; 12-1 O.C.C. Q.J. 18, March, 1993). We suggest the Board should specifically include those activities in its non-exclusive list.

* * *

As noted at the beginning of this letter, we appreciate the Board’s efforts to bring a measure of clarity and certainty to the application of section 106. While we believe the proposed interpretation is an important step forward, much remains to be done to ensure the proposed interpretation and supervisory guidance do not act as a barrier for banks providing the services in the manner increasingly demanded by their customers and provided by banks’ competitors. If you have questions concerning this letter, please do not hesitate to contact Mr. John Huffstutler (704-388-6724) or Mr. Patrick Antrim (704-386-4241).

Sincerely yours,

Paul Polking
General Counsel