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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

Via Email: regs.comments@federalreserve.gov

Comment Letter on Proposed Interpretation and Supervisory Guidance
Docket No. OP-1158

Dear Ms. Johnson:

We are pleased to submit this comment letter on the proposed interpretation and supervisory guidance with request for public comment (the "Proposal") issued by the Board of Governors of the Federal Reserve System (the "Board") on August 25, 2003 and published in the Federal Register on August 29 (68 Fed. Reg. 52024), providing an interpretation and guidance on the requirements of Section 106 of the Bank Holding Company Act Amendments of 1970 ("Section 106"). We represent many of the largest banking and financial institutions in the world and have dealt extensively with the requirements of Section 106 in a wide variety of transactions affecting them.

In general, we commend the Board and its staff on an extremely well-written, logical and helpful document setting forth the general concepts applicable to Section 106. To our knowledge, there has not been an authoritative statement of the scope of Section 106 and its proper interpretation under various factual settings prior to issuance of the Proposal. In general, the Proposal sets forth the applicable statutory requirements with admirable clarity and precision and for the most part reaches what we consider to be the clearly correct conclusions concerning their application.

We have two major comments concerning the Proposal and three minor comments and suggestions.

1. Economic power.

The proposed interpretation states clearly the Board's belief that Section 106 does not require that a bank have any particular degree of market power as a prerequisite to finding a

violation. Board staff has been presented a voluminous amount of material and discussion that we believe persuasively makes the case that Section 106 can and should be read to require exactly that. We continue to believe that the reason that the legislative history and case law on Section 106 is confused is that the statute's enactment was based on a false premise, that a transaction in money, rather than in goods or services, might not be subject to the anti-tying prohibitions of the Clayton and Sherman Acts. After the bill with the original statutory language was introduced, the Supreme Court's decision in *Fortner Enterprises* v. *United States Steel Corp.*, 394 U.S. 495 (1969), was issued, and that decision made clear that loans and credit could be tying products. Indeed, Government officials are quoted in the legislative history as stating that the Fortner decision may have made the statute unnecessary.

We believe that a very good case can be made that the point of Section 106 was to apply the anti-trust law on tying to bank transactions, which would bring with it the market-power requirements of antitrust law. The consequence of such a reading would be that bank products would be subject to the same requirements of antitrust law that apply to others, requiring a finding of market power in a particular product before a violation of Section 106 could be found. We acknowledge the awkwardness that it may cause to agree with this view over 30 years after the statute's passage, but on the other hand the Board has not issued a comprehensive statement of its interpretation of the statute prior to the proposal under review here. Now would be the time to set forth this position and deal with its implications.

If the Board does not do so, we make the following comments on the proposed interpretation.

2. Mixed-product arrangements.

We strongly urge the Board to reconsider the position taken by the Proposal in connection with mixed-product arrangements.

The Board appears to take the not illogical position that an arrangement whereby a bank conditions the availability of a bank product for a customer (a "Company") on the amount of revenue generated by a Company from all products will comply with Section 106 only if the Company has a "meaningful option" to meet the condition by choosing traditional bank products in order to generate that amount. We understand the logic to be that an arrangement whereby a Company is forced, as a practical matter, to obtain non-traditional bank products in order to obtain the desired product means that the bank has conditioned the availability of the desired product on the acquisition of tied products that do not qualify as traditional bank products. We also understand that the general contours of this position have been proposed by others as a way to resolve this knotty issue.

We believe that the Board's proposal would be unfair to many banks and would be extremely difficult if not impossible to implement.

It may be practical for large U.S. banks to comply with the Board's interpretation due to the wide range of traditional bank products that they offer. Some U.S. banks, especially

the large money center banks, offer a great variety of cash management products, credit products, custody arrangements and the like that make it feasible for a Company to be able to meet the banks' hurdle rates solely from those products. However, many banks in the United States offer a narrower range of traditional bank products. Among other things, they do not have the capacity to support the sophisticated systems that are required in order to provide the same variety of cash management and other bank products as the largest banks. This is especially true for many non-U.S. banks with branches and other operations in the United States. Their narrower focus on a wholesale customer base and their more targeted provision of financial services in the United States will likely make it much more difficult for them to offer the range of traditional bank products that would give a "meaningful option" to a wholesale customer. As a result, the more narrowly-focused banking organizations will be at risk that the Board or other regulatory agencies will determine that their mixed-product arrangements do not meet the requirements of the Proposal.

In addition, the Board's proposed approach would require a bank to determine whether particular traditional bank products should be considered to be available in reality to a particular Company. For example, a bank might decide that its global securities custody services should be treated as a traditional bank product available to all Companies. However, many Companies do not hold securities outside the United States, and many may hold a very modest portfolio inside the United States. This fact would likely make it questionable whether global securities custody services are a product that the Company would actually need. Will it be part of the Board's interpretation that a bank must make a determination whether particular services are actually of use to a particular Company? If so, how much latitude may a bank have in making this determination? Many banks would be tempted, while designing a system to make such determinations, to assert as great a degree of latitude as they can get away with in deciding that a particular product is potentially useful for a Company, and therefore a "meaningful option".

Even if the Board decides to retain the Proposal's general requirements on mixed-product arrangements, we strongly suggest that it reconsider the extent to which the "meaningful option" requirement is focused on a particular Company. We note with consternation the provision in footnote 51, which we believe was probably intended to give some comfort, that a Company "would have a meaningful option even though Company had a long-standing cash management arrangement with another financial institution so long as Company may legally transfer its cash management business to Bank...." (68 Fed. Reg. at 52031). We submit that it is not practical for banks to factor into a mixed-product arrangement the contractual arrangements for all traditional bank products that a Company might have at any particular time with other banks. It is not at all clear that Companies will volunteer detailed information on the services they obtain from other banks. Even if they were willing to give such general information, it is even less clear that Companies would be willing to reveal the terms of the contracts with those banks, including such facts as expiration dates, cancellation terms and the like. It is far less likely that a bank could verify what the Companies tell them unless the Companies provide copies of the contracts, which is rarely going to happen. Finally, for a major organization with a variety of banking needs, it will be simply too great an analytical job for a bank to analyze all of

a Company's services and contracts to figure out whether whatever the bank wants to offer amounts to a meaningful option for that Company at that time. We strongly believe that linking a Company's legal obligations to other institutions to compliance with Section 106 is simply an unworkable requirement.

If the Board retains the legal rights of the Company as an element of the test, then the question becomes one of boundaries. For example, if a Company has an exclusive cash management contract with another bank that expires in three months, may be the bank treat the opportunity to obtain its cash management services as "meaningful"? If three months is permissible, is six months? One year? And are there different time periods that should be treated as the outer limit for other types of services? Banks would have to make decisions on these points. We submit that it would be very tempting to many banks to design their arrangements in such a way as to try to pass muster with the examiners while failing to adhere to the spirit of the requirement. Effectively they would be "gaming" the system in order to give *themselves the maximum degree of flexibility that they believe they could get away with.*

We submit that the requirement that a Company have a "meaningful option" to acquire solely traditional bank products will lead to a range of artificial and arbitrary distinctions that will raise more questions than they answer and create a whole new area needing detailed supervisory guidance and review. This is especially problematic because, if we read the interpretation and guidance correctly, the mixed-product arrangement described in the interpretation is the only way that the Board would recognize as one that complies with Section 106. Any other arrangement appears to be one that does not comply, or that at least would be subject to a heavy burden of proof that it complies, with Section 106.

We believe that the Board is not legally required to go so far in order to implement Section 106. Rather, we believe that the Board may find that, at least in the wholesale banking market, competitive forces make it unnecessary to adopt the detailed requirements set forth in the interpretation that a Company must, in all cases, be able to meet a bank's hurdle rate by acquiring only traditional bank products. Rather, because of the great range of financial products and services generally needed by the wholesale users of bank services, the granular analysis proposed by the Board can be replaced by a more general requirement that any mixed-product arrangement is permissible so long as the bank has a system of measuring previously-obtained business or likely future business from the customer and that the system is not geared in such a way as to give the customer no choice but to acquire non-traditional bank products. While such a rule would not give detailed guidance to examiners or to banks, it would at least give them the freedom to design systems that the Board and other regulators could review and analyze at the time. We see no other practical way to permit mixed-product arrangements to exist.

3. Offshore services.

While we believe that the "meaningful option" requirement should be removed, in the event that it is retained, we suggest that the interpretation clearly state that traditional bank products offered by non-U.S. affiliates, whether banking offices or non-bank affiliates, may be

treated as products eligible for this treatment. One way that the use of traditional bank products in the mixed-product arrangement rules might be more workable for non-U.S. banks would be to make clear that traditional bank products provided by non-U.S. offices and affiliates of the bank may be treated as eligible products for this purpose. It seems clear that such a position is supportable. The Board permits domestic banks to tie traditional bank products offered by non-bank affiliates, and there is no indication that this is limited to products offered by domestic affiliates. The Board's safe harbor for transactions with non-U.S. customers, based on legal precedent that Section 106 should not apply outside the United States in the same manner that antitrust law generally does not apply outside the United States, should not be read to limit the interpretation.

4. Foreign exchange.

The proposed interpretation at Section IV.A.1. sets forth a very helpful list of traditional bank products. We recommend that the Board determine that the provision of foreign exchange-related services and products is a traditional bank product or service and include them on the list. The provision of such services and products is clearly "related to and usually provided in connection with" the provision of credit and other banking services; after all, banks have provided foreign exchange services and products since the Medicis. An additional basis for this position is that foreign exchange at the wholesale level is generally done on the basis of buying and selling deposit liabilities on the books of banks, and therefore is a deposit service, which is specifically mentioned in Section 106. In order to obviate any uncertainty on this point by the absence of specific mention, we recommend that foreign exchange-related services and products be set forth on the list.

5. Exclusive dealing.

Section IV.C. of the proposed interpretation does not explicitly state that a voluntary agreement by a customer to an exclusive dealing provision does not violate Section 106, but it appears that the logic applicable to tying arrangements generally should apply here. We recommend that the interpretation be revised to provide an explicit statement to that effect.

We appreciate the opportunity to submit these comments and are willing to respond to any questions that staff might have on any of them.

Very truly yours,

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