**THE ASSOCIATION OF THE BAR
OF THE CITY OF NEW YORK
42 WEST 44TH STREET
NEW YORK, NY 10036-6689**

COMMITTEE ON BANKING LAW

BRADLEY K. SABEL
CHAIR
599 LEXINGTON AVENUE #1652
NEW YORK, NY 10022
(212) 848-8410
FAX: (646) 848-8410
bsabel@shearman.com

DOUGLAS LANDY
SECRETARY
599 LEXINGTON AVENUE #1654
NEW YORK, NY 10022
(212) 848-8826
FAX: (646) 848-8826
dlandy@shearman.com

September 30, 2003

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

Via Email: regs.comments@federalreserve.gov

RE: Docket No. OP-1158

Ladies & Gentlemen:

The Association of the Bar of the City of New York ("ABCNY" or the "Association")[1] welcomes the opportunity to comment, based on the recommendations of its Committee on Banking Law, on the proposed interpretation and supervisory guidance (the "Interpretation") issued by the Board of Governors of the Federal Reserve System (the "Board") on the Anti-Tying Restrictions of Section 106 of the Banking Holding Company Act Amendments of 1970 (the "Anti-Tying Restrictions" or "Section 106").

We are pleased that the Board has decided to publish interpretive guidance on a subject of great importance to the banking and financial services industry, one that has recently been the focus of increased attention on the part of various legislative and regulatory bodies. As ABCNY has previously observed, the concept of the Anti-Tying Restrictions is often

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1 The Association is one of the oldest and largest local bar associations in the United States, with a current membership of over 22,000 lawyers. The Association serves not only as a professional association, but also a leader and advocate in the legal community on a local, state, national and international level. The Association pursues its advocacy role through the work of over 170 committees, each devoted to a substantive area of the law. Among other activities, the Association's committees prepare comments for legislative bodies and regulatory agencies on pending and existing laws and regulations that have broad legal, regulatory or policy implications. Further information regarding the Association can be found at the Association's website, www.abcny.org.

misunderstood and misconstrued.[2] The Association believes that the Board, with its many years of experience in interpreting and enforcing the Anti-Tying Restrictions, should be the sole issuer of definitive guidance on Section 106, through the Interpretation. Moreover, the Association is also pleased that the Board addresses in the proposed Interpretation several of the concepts discussed in the Association's May 8, 2001 to the Board ("2001 Letter"), a copy of which is enclosed, in which we recommended that the Board consider exempting, by regulation, certain large commercial loan transactions and arrangements in the "wholesale" banking business.

The Association appreciates the Board's comprehensive and thoughtful analysis of Section 106 and, for the most part, concurs with the Board's stated conclusions regarding the interpretation of Section 106. We believe the "Question and Answer" format, and the inclusion of specific examples of common situations that arise under Section 106 and the Board's analysis of them, are well-done and will provide extremely helpful guidance to both banking organizations and supervisors as they attempt to navigate the legal and regulatory challenges of the post-Gramm-Leach-Bliley world of integrated financial services.

More specifically, the Association respectfully submits the following comments and recommendations regarding the proposed Interpretation.

Lending and Derivative Products

In Section III. A. of the proposed Interpretation, the Board specifically requests comment on how interest rate swaps, foreign exchange swaps, and other derivative products that are often connected with lending transactions should be treated under Section 106. The Association believes that when an interest rate or foreign exchange swap or other derivative product has been negotiated in connection with a proposed lending transaction for the purposes of mitigating the risks of extending credit to the relevant borrower, such derivative should be analyzed as an integral element of the loan transaction and not as a product in its own right. Derivatives transactions entered into between a bank and a customer in such circumstances should not be prohibited by the Anti-Tying Restrictions.[3]

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2 See the Association's comment letter to NASD dated October 21, 2002 regarding *Special Notice to Members 02-64, Prohibition of Certain Bank Tying Arrangements.* A copy of this letter is enclosed for your reference.

3 In footnote 23 of the proposed Interpretation, the Board explains that "[a]s 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." Although there is certainly customer demand for derivatives apart from the area of loans, and although banks do provide certain lending products and transactions separately from derivatives products as a general matter, we agree with the Board that a determination of whether something is one or two products is a "highly fact-intensive inquiry that depends on the nature and the character of the products and markets involved." In certain factual circumstances and in certain transaction scenarios, ABCNY believes that lending and derivatives products can be viewed as one rather than two products.

For example, it may be more economically efficient (and, hence, less risky for the lender) for a borrower to agree to a particular fixed or floating interest rate on its loan, but then simultaneously negotiate an interest rate swap or cap pursuant to which the borrower can swap all or part of its fixed or variable interest rate risk on the loan to another interest rate basis or cap a floating exposure. Similar arrangements are often made in multi-currency loan facilities, where a borrower may swap and/or hedge certain currency conversion risks under a credit facility for other currency exposures. In such cases, the derivative may be as key a part of the risk profile of the lending transaction as the stated interest rate on the loan because it facilitates the management of the borrower's interest rate or currency risks. As a result, when a derivative is an integral part of a lending transaction, ABCNY believes that it is not inappropriate under Section 106 to view these transactions as "one product". This approach will enable banks to offer credit to customers on the most efficient and flexible basis possible.

ABCNY also respectfully recommends that the Board use its exemptive authority under Section 106 to clarify that all derivative products that are permissible for banks to engage in with customers are deemed to be "traditional bank products," even if a derivative product is not so much an integral part of a lending transaction so as to be treated as one product Banks are, and have been for years, some of the most important participants in the markets for certain derivatives products. For many banking organizations today, the offering to customers of derivatives such as interest rate and currency swaps is viewed as traditional a banking activity as the making of loans and the taking of deposits. Congress, in Section 206 of the Gramm-Leach-Bliley Act of 1999, explicitly recognizes certain types of swap agreements as "identified banking products." At a minimum, the Board should consider providing "traditional bank product" status to derivatives that qualify as "identified banking products."

Relationship Banking

The Association applauds the Board for recognizing the concept and permissibility of certain types of "relationship banking" arrangements in its discussion of Mixed-Product Arrangements in Section IV.A.2. of the proposed Interpretation. As the Association noted in its 2001 Letter, "relationship banking" is often demanded by customers of their banks. It would be a perverse result under Section 106, which was intended to prevent the abuse of a bank's economic power over its customers, if the bank was unable to ensure that its business relationship with the customer was profitable based on the package of relationship services. Therefore, the proposed Interpretation recognizes that banks can set internal "hurdle rates," or profitability targets, for particular customers or types of customers that can be met through the purchase of one or more products in a mixed-product arrangement.

However, according to the proposed Interpretation, such a mixed-product arrangement would be permissible under Section 106 if the customer would have "a meaningful option" to satisfy the "hurdle rate" solely through the purchase of one or more "traditional bank products" and not be required to take non-traditional bank products. Although we appreciate the Board's attempt to balance the permissibility of "relationship banking" with the policy rationale underlying the prohibition against the tying of traditional and non-traditional bank products, ABCNY questions whether the "meaningful option" criterion will prove workable in practice, particularly when a bank will need to make that determination on a prospective basis.

Footnote 51 of the proposed Interpretation, in which the Board attempts to illustrate by an example the "meaningful option" criterion, helps illustrate the Association's concern with the implementation of this standard. Based on that example, would it be necessary for a bank to determine what other relationships a customer may have with other banks or financial institutions with respect to "traditional bank products," as well as the nature of the duration and pricing of such arrangements, in order to determine whether it is, in fact, providing the customer with a "meaningful option" to satisfy the hurdle rate solely through traditional banking products? The Association is concerned that this criterion could lead to examiners "second guessing" banks' actions in this area.

Against this backdrop and to provide clearer guidance to banks with respect to mixed-product arrangements, we respectfully recommend that the Interpretation address two additional points. First, we suggest that the Interpretation make clear that it is permissible under Section 106 for a bank to at least discuss its approach to relationship banking with a customer, even if it has not yet done a full mixed-product analysis, so long as the bank is not imposing any impermissible condition on any grant of credit. Second, it would be helpful if the Interpretation clarified that even in a case where a bank does not offer an array of traditional bank products that would constitute a permissible mixed-product arrangement under Section IV. A. 2., it is permissible for a bank to cease providing credit to a customer if (1) the loan was not tied to another product when extended and (2) the relationship has not met the bank's "hurdle rate" as a result of voluntary use by the customer of other products and services (whether traditional or non-traditional).

"Wholesale" Banking Exemptions

Finally, the Association would like to reiterate and update the recommendations contained in its 2001 Letter that the Board exempt from the Anti-Tying Restrictions certain types of transactions in "wholesale" banking arrangements where the policy objectives of Section 106 are not adversely impacted. In its 2001 Letter, the Association proposed that the minimum amount at which an extension of credit be conclusively presumed to be a wholesale transaction was $25 million. The Association now believes that a more appropriate minimum figure is $50 million. Therefore, the Association continues to recommend that the following extensions of credit be exempted from Section 106, provided that the amount of each such extension of credit is at least $50 million:

a) Bridge loans made in anticipation of a securities offering the proceeds of which will be used to retire the bridge loans;

b) Syndicated loans made to institutional or corporate borrowers by a group of two or more lenders; and

c) Credit facilities used to back up or facilitate a company's non-banking funding programs, such as a commercial paper facility.

We leave to the discretion of the Board whether these recommended exemptions can be accommodated under the proposed Interpretation or would require further Board action.

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Once again, the Association commends the Board for its thoughtful and timely action in proposing the Interpretation. We thank you for the opportunity to comment and appreciate your consideration of our recommendations. If you have any questions regarding this letter or wish to discuss our comments further, please contact the Chair of the ABCNY Committee on Banking Law, Bradley K. Sabel, at 212-848-8410, or Douglas Landy, Committee Secretary, at 212-848-8826.

Very truly yours,

Bradley K. Sabel

Bradley K. Sabel
Chair, Committee on Banking Law

Enclosures

ABCNY COMMITTEE ON BANKING LAW MEMBERSHIP

Not all of the Committee members participated in the preparation of this letter, nor did the participation of a member mean that he or she supported the views expressed in this letter. Moreover, the Committee members acted only as individuals and not as representatives of the organizations to which they belong or by which they are employed, and therefore the views expressed in the letter are not to be considered the views of any governmental, commercial or private organization other than the Association.

Patricia E. Brigantic
Bowman Brown
John B. Cairns
Marcy S. Cohen
Micheal A. Cohen
Guy C. Dempsey
Rose M. De Vries
Dennis Dumas
Bernhard Faber
Paul E. Glotzer
Steven J. Green
Franca H. Gutierrez
Sara A. Kelsey
George P. Lindsay
Norman R. Nelson
Michael C. Nissim
Wendy C. Pelle-Beer
Mark S. Pesso
Allan E. Reznick
Bradley K. Sabel
Sandra Scarlatella
Kathleen A. Scott
Elizabeth M. Schubert
Howard Steinberg
Jane Summers
Eric K. Tarlow
Paul N. Watterson
Robert B. Weintraub
Gregory H. Woods
Sooryun Youn