MEMORANDUM

To: Section 106 Guide Public File

From: Mr. Van Der Weide

Date: June 24,2004

Subject: Conference Call with Bank Group led by John Walker, Esq.

On May 27,2004, representatives of the Federal Reserve System (Messrs. Van Der Weide, Baer, Hurwitz, Borzekowski, and Brevoort and Ms. Hansen) participated in a conference call with John Walker, Esq. and representatives of Citigroup, JP Morgan Chase, Deutsche Bank, Bank of America, and UBS to discuss an exception from section 106 of the Bank Holding Company Act Amendments of 1970 for tying arrangement involving large corporate customers. Mr. Walker and the bank group submitted the attached document, which served as the basis of the discussion on the call. Mr. Walker indicated that he and the bank group would submit additional evidence and data in support of granting the proposed large customer exception from section 106 set forth in the attached document.

Attachment

Ladies and Gentlemen,

Attached is a definitional framework for a section 106 "large customer" safe-harbor exemption. The bank group members are utilizing this framework to collect and provide to the Federal Reserve information and data that supports the definition of "large customer" that is set out in the framework. The framework is not intended to serve as proposed regulatory language, but rather is intended to facilitate the collection of such information and data by the bank group members. Certain numbers in the definitional framework are in brackets pending the information and data that the bank group members are collecting (such information and data may indicate that such numbers should be adjusted upwards or downwards),

Also attached is a framework for a coercion interpretation. The bank group believes that the "large customer" safe-harbor exemption is complementary to the coercion interpretation. Again, the coercion interpretation framework is not intended to serve as proposed language for a final section 106 interpretation, but rather is intended to set out the substantive points that the bank group believes should be included in the final interpretation.

Both attachments are in line with the discussion at our May 3 meeting with Board staff.

The bank group would like to discuss the proposed "large customer" framework with Federal Reserve staff as the banks are collecting the relevant information and data based on the framework. If it would be convenient for you, we would propose to schedule a conference call with you for this Thursday afternoon, May 27, at any time.

In addition to planning to provide information and data from the bank group members to support the "large customer" exemption, we are also hoping to provide information from certain independent sources (for example, the Loan Pricing Corporation and rating agencies).

Mark, could I ask you to circulate this to Ken Brevoort and Ron Borzekowski in S&R? Bonnie, could I ask you to see if a the proposed conference call on Thursday would be convenient? Many thanks.

Best regards.

John

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Safe-Harbor Exemption

Safe harborfor large customers. The prohibitions of section 106 shall not apply to any proposed or executed transaction between a bank and a customer if at the time negotiations between the bank (or any affiliate thereof) and the customer with respect to such transaction are commenced or at the time such transaction is entered into, after giving effect to such proposed or executed transaction, the customer either is a large customer that is not the obligor on any distressed debt obligation or is an affiliate of such a large customer. "Large customer" means:

(a) any person other than an individual ("entity") that on a consolidated basis is the obligor or guarantor on outstanding debt obligations, including commitments to lend, of $[100] million or more in aggregate;

(b) any entity that on a consolidated basis had in its financial statements for the immediately preceding four quarters, in aggregate, gross revenues of $[500] million or more;

(c) any entity that is managed or controlled, directly or indirectly, by one or more financial sponsors any of which has $[1] billion or more under management;

(d) any entity that, within the five years immediately preceding the time negotiations with respect to a transaction commenced or the time such transaction is entered into, has issued outstanding debt obligations that are rated investment grade by a nationally recognized statistical rating organization; or

(e) any entity that, within the five years immediately preceding the time negotiations with respect to a transaction commenced or the time such transaction is entered into, has issued outstanding debt or equity securities pursuant to the registration requirements of the Securities Act of 1933, as amended, or pursuant to Rule 144A issued thereunder.

"Distressed debt obligation'' means any outstanding debt obligation, including loans and public or private debt securities, of an obligor (i) that, in the case of a debt security, has traded on average for [five] consecutive business days during the immediately preceding [60]-days at a [35]% or greater discount from its face amount (or accreted amount in the case of a debt security issued at a deep discount), (ii) for which, in the case of a loan trading in the secondary market, the [bid or offer rate at any time during the immediately preceding [141-days] is at a [20]% or greater discount from its principal amount, or (iii) that, to the bank's knowledge, has been classified as substandard, doubtful or loss by a federal banking agency or a State bank supervisor.

Final Interpretation

The final interpretation and supervisory guidance regarding section 106 (the "Final Interpretation") should include two separate and independent tests: (i) a meaningful option analysis for mixed-product arrangements performed with respect to various classes of customers, and (ii) a coercion analysis to the following effect:

Coercion analysis. The Board concludes that a violation of section 106 may occur only if a bank coerces or forces a customer to obtain (or provide) the tied product as a condition to the customer obtaining the desired product from the bank. *See, e.g., Tic-X-Press, Inc. v. Omni Promotions Co.*, 815 F.2d 1407, 1415 (11th Cir. 1987) ("[T]he plaintiff must establish that seller forced or coerced the buyer into purchasing the tied product."). Such coercive tie-ins forced or imposed on a customer by a bank will violate section 106, unless an exemption is available for such tie-ins. Section 106 does not apply where a customer voluntarily seeks and obtains from a bank or its affiliates multiple products that the customer desires. Further, section 106 does not apply where a customer uses its business leverage to obtain from a bank or its affiliates a package of products that the customer desires, in which case the bank or its affiliate is free to negotiate with and propose to the customer a counteroffer with regard to one or more products.

Under section 106, a bank may present a tying arrangement to a customer so long as the bank reasonably believes that the customer is not being coerced or forced to accept the arrangement. Coercion does not occur simply because a bank offers an economic incentive for a customer to agree to its proposal; for coercion to occur, the customer must be unable to freely choose among the choices that are made available to it. Proof that no coercion or force is involved may be shown by the nature of the customer relationship as well as by the competitive landscape. For example, a bank may present a tying arrangement to a customer that has a sophisticated Chief Financial Officer and other well-trained staff (*e.g.*, the corporation has a sizable treasury operation) who are fully capable of negotiating favorable terms for a desired product on a stand-alone basis or tied to other products or services, just as such customers currently do when they negotiate with financial institutions that are not subject to section 106. In addition, if a bank can show that a customer has one or more *bona fide* alternative sources of the desired product or that one or more other financial institutions are bidding on a *bona fide* basis to provide the desired product to the customer on similar terms, then clearly no coercion or force would be involved unless there is some demonstrable reason why the customer is being prevented from choosing among the alternative sources or bids.

While this coercion analysis may be applied on a case-by-case basis, the Board believes that a class of customers can be described that, subject to certain conditions, are not susceptible to the coercion that section 106 seeks to prevent, and accordingly, the Board has adopted a safe-harbor exemption for these "large customers," as discussed below. Such an exemption provides greater certainty as to the general permissibility of tying arrangements with such customers. Even though a practice may not be prohibited under section 106, the Board has recognized that

granting an exemption for the practice provides certainty as to the permissibility of the practice. *See, e.g.*, *Huntington Bancshares*, 82 Fed. Res. Bull. 688, 690 (1996). Nevertheless, a transaction with a customer that falls outside the safe harbor will only violate section 106 if the customer is in fact coerced or forced; a transaction that falls outside the safe harbor should not be presumed to involve coercion or force. Rather, the safe-harbor exemption is being adopted because large customers as defined in the safe harbor presumptively cannot be coerced or forced.