July 17, 2001

Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-0609

Re: Bank Broker-Dealer Interim Final Rules: Release No. 34-44291; File No. S7-12-01; 66 Federal Register 27760 (May 18, 2001).

Dear Mr. Katz:

The American Bankers Association ("ABA")[1] and the ABA Securities Association ("ABASA")[2] appreciate the opportunity to comment on the interim final rules recently released by the Securities and Exchange Commission ("Commission"). These rules address the exceptions from broker-dealer registration, more commonly called ""the push-out" provisions, contained in Title II of the Gramm-Leach-Bliley Act. While the final rules were released on May 11, 2001, one-day before Title II was scheduled to go into effect, compliance with these rules is, for all practical purposes, delayed until October 1, 2001.[3]

As we previously informed the Commission in our letter of June 4, 2001, the ABA and ABASA are strongly opposed to the interim final rules. Our opposition to the rules is chiefly grounded upon the belief that the interim final rules do not comport with the plain meaning of the Gramm-Leach-Bliley Act and its legislative history. We highlight below some of the more troublesome positions taken by the Commission. In addition, we are also opposed, as discussed

[1] The ABA brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership—which includes community, regional, and money center banks and holding companies, as well as savings associations, trust companies, and savings banks—makes ABA the largest trade association in the country.

[2] ABASA is a separately chartered affiliate of the ABA representing those holding company members of the ABA that are the most actively engaged in securities underwriting and dealing activities, offering proprietary mutual funds, and derivatives activities.

[3] For those banks that do not satisfy the various exceptions' compensation requirements, compliance with the compensation requirements only is further delayed until January 1, 2002.

more fully below, to the huge regulatory burdens placed on the banking industry by the interim final rules.[4]

We are mindful, however, that Commission staff, since the May 11th release of the interim final rules, has conducted a series of meetings with various industry groups in order to get a clear understanding of the difficulties that the banking industry will experience when the interim final rules become effective on October 1, 2001.[5] The ABA and ABASA are both appreciative of those efforts and hopeful that these discussions will result in significant revisions to the interim final rules.

We also appreciate recent statements by Commission staff to the effect that it may be appropriate to provide additional time to come into compliance with the interim final rules. In addition, Commission staff has indicated a willingness to provide additional time to comply with any significant changes to the rules that the Commission may make in response to comments received.[6]

Our members are nevertheless in a quandary, caught between the proverbial rock and a hard place. Simply put, the banking industry does not know whether it should expend the millions of dollars, as well as the vast amount of employee time, necessary to comply with the interim final rules as issued or wait until the Commission indicates whether or not significant revisions to the interim final rules will be made.

The ABA and ABASA strongly urge the Commission to take steps to resolve this uncertainty. Specifically, we call upon the Commission to announce immediately a delay in the October 1, 2001 and January 1, 2002 effective dates. Moreover, once the Commission has had the opportunity to consider the comments received regarding the interim final rules and, hopefully, revised those rules accordingly, the Commission should give the industry sufficient lead time to comply with the final rules.[7] As we have previously discussed with the staff,

---

[4] We submit comments on behalf of all of our members, including those that are authorized under federal or state law to exercise fiduciary powers. In this connection, we are particularly pleased by the Commission's determination to provide, in new Rule 15a-9, much needed relief from broker-dealer registration for savings banks and savings institutions. Specifically, these institutions will now have the same exemptions from broker-dealer registration as commercial banks and trust companies. We would also strongly urge the Commission to consider exempting savings banks and savings institutions from investment adviser registration, under the Investment Advisers Act of 1940, 15 U.S.C. 80b-1 *et seq.*

Our support for new Rule 15a-9 should only be read in conjunction with our comments on the interim final rules, however.

[5] As we noted in our earlier letter to Chairman Laura Unger dated February 28, 2001, the staff also met with industry representatives on several occasions prior to issuing the interim final rules. Since October 2000, the staff has met with ABA and ABASA representatives on at least four occasions and entertained two letters requesting interpretive guidance. See Letters to Catherine McGuire, from Sarah Miller, ABA and ABASA, dated November 7, 2000 and January 26, 2001.

[6] See Letter from Annette L. Nazareth, Director, Division of Market Regulation, to Beth L. Climo, Executive Director, ABA Securities Association, dated June 28, 2001.

[7] We note also that the bank regulators are charged, under Section 204 of the Gramm-Leach-Bliley Act, with developing recordkeeping rules for banks that rely on the broker-dealer exceptions contained in Title II. The bank regulators have delayed issuing proposed recordkeeping rules pending Commission consideration of the many

revisions to bank compensation structures and fee schedules are generally implemented at the beginning of a calendar year to facilitate customer and employee preference for calendar year tax reporting. Accordingly, any significant revisions to current compensation and fee schedules required by the rules optimally should become effective at the commencement of a calendar year, i.e., January 1, 2003.[8]

Moreover, the Commission's determination to adopt new Rule 15a-8 which provides for an exemption for contracts entered into by banks before January 1, 2003, from being considered void or voidable by reason of Section 29 of the Securities Exchange Act of 1934[9] is most welcome. In the event the Commission determines to delay the October 1, 2001 and January 1, 2002 effective dates, we would hope that a delay of commensurate proportion would be provided under new Rule 15a-8.

DISCUSSION

The banking industry's primary concerns regarding the interim final rules center predominantly on the huge regulatory burdens associated with implementing the trust and fiduciary exception's "chiefly compensated" standard and the industry's inability to provide meaningful order-taking services for custodial accounts under the safekeeping and custody exception – an activity in which banks have traditionally engaged. In addition, we are opposed to the overly restrictive conditions assigned to referral fee programs under the networking exception and sweep fee services. We also have concerns with the narrow interpretations taken by the Commission regarding several other provisions contained in the trust and fiduciary exception. We discuss in detail below these concerns.

I. The Trust and Fiduciary Exception

A. The interim final rules require banks to spend millions of dollars in order to comply with an overly complicated formulation of the Trust and Fiduciary exception's "chiefly compensated"standard.

The banking industry opposes the interim final rules for the sheer magnitude of the regulatory burdens imposed on banking organizations. Primary among those regulatory burdens

---

significant issues raised by the interim final rules. It would be helpful if the Commission and the bank regulators could coordinate effective dates for both the Title II exceptions and the recordkeeping requirements for banks relying on those exceptions.

[8] As we discuss later in this letter, there is insufficient time to implement many of the compensation provisions required by the interim final rules by the January 1, 2002 effective date. Moreover, we believe that a January 1, 2002 effective date gives the industry insufficient lead time to implement any revised and simplified final rules the Commission may ultimately issue.

[9] Section 29(b) provides that any contract made in violation of the Exchange Act or Exchange Act rules shall be void as regards the rights of any person who made or engaged in the performance of any such contract. 15 U.S.C. 78cc(b). As the Commission notes, private parties have occasionally invoked this remedy in instances involving broker-dealer registration violations by the opposite party. See Rel. No.34-44291, 66 Fed. Reg. 27760, 27787 at n. 241 (May 18, 2001).

is the trust and fiduciary exception's "chiefly compensated" standard, as laid out in the interim final rules.

The statute requires that banks claiming the trust and fiduciary exception must be "chiefly compensated" by way of an annual or administrative fee, a fee based on a percentage of assets under management, a flat or capped per order processing fee equal to not more than the cost incurred by the bank in processing the securities transaction or any combination of these fees.[10] In response to requests from the industry,[11] the Commission has defined "chiefly compensated" as requiring relationship compensation to exceed sales compensation. We concur with the Commission's determination that the measure of "chiefly compensated" requires the types of compensation enumerated in the statute as permissible to exceed sales compensation. The Commission defines permissible compensation as "relationship compensation."

We, however, take issue with the overly complicated analyses required by the Commission for determining what is permissible relationship compensation and what is sales compensation. We also continue to be strongly opposed to an account-by-account calculation, as opposed to the line-of-business calculation, that we have previously advocated.[12]

Several of our members have indicated that if the Commission continues to adhere to this formulation of "chiefly compensated," they will be forced to expend millions of dollars to develop the requisite technology required to comply. One very large bank estimated a total technology cost to comply with the interim final rules of $15 million. In addition, many regional and smaller trust institutions outsource much of their system needs. System providers estimate that the costs to develop software required by the Commission's rules would be significantly higher than $15 million. These same providers have expressed doubt as to whether 50-60 percent of their client base could even afford the developed system.

In terms of time needed to comply with the "chiefly compensated" standard, there appears to be unanimity on this point – 12 to 18 months, at a minimum, is needed to develop in-house the software, to test the software, to pilot it with a limited number of accounts, to make necessary system changes, to install the software and to train employees on the use of that software. The complexity and costs associated with this task is increased due to the fact that, unlike the brokerage industry, bank trust information technology ("IT") systems tend to be universal. By that we mean, that one program or system performs all functions for the trust and asset management departments, including tax, accounting, and regulatory reporting. As a result, software adjustments would require changes to the entire system, impacting all aspects. On the other hand, in the brokerage industry, different systems are created for single purposes. Therefore, a change to one system can be made without impact on all other systems. Indeed, the very cost to develop a trust system to measure "chiefly compensated" as currently structured by the Commission could well cause many institutions to "push-out" traditional trust and fiduciary

---

[10] See Paragraph 3(a)(4)(B)(ii).

[11] See Letter to Catherine McGuire, Associate Director, Division of Market Regulation, Securities and Exchange Commission from Sarah Miller, ABA and ABASA, dated January 26, 2001.

[12] Id.

activities to a broker-dealer – which is the very result that the Congress in providing the exception intended to avoid.[13]

1. The definitions of relationship compensation, sales compensation, and unrelated compensation are overly complicated, create huge compliance burdens for the banking industry, and are not called for by the statute.

The interim final rules explain that the "chiefly compensated" standard requires "relationship compensation" to exceed "sales compensation." "Relationship compensation" is then defined as an "administration or annual fee (payable on a monthly, quarterly, or other basis), a percentage of assets under management fee, or a flat or capped per order processing fee equal to not more than the cost incurred by the bank in connection with executing securities transactions for trust and fiduciary accounts, or any combination of such fees." These fees are specifically enumerated in the statute as permissible or eligible trust and fiduciary compensation.

The Commission then adds to the definition of "relationship compensation" a requirement not found in the statute. Specifically, the fees that constitute "relationship compensation" must be received directly from a customer or beneficiary, or directly from the assets of the trust or fiduciary account.

The Commission also elaborates on the meaning of "flat or capped per order processing fee." Specifically, the new Rule 3b-17(b) defines it as "a fee that is no more than the amount a broker-dealer charged the bank for executing the transaction, plus the costs of any resources of the bank that are exclusively dedicated to transaction execution, comparison, and settlement for trust and fiduciary customers."

Dedicated resources, we are told, would include the salary of a bank trust department employee whose sole responsibility is working on a trading desk that is exclusively dedicated to executing and comparing trades for trust or fiduciary customers. These dedicated resources would also include IT resources exclusively related to trade execution, comparison, and settlement for trust or fiduciary customers, such as trade execution and comparison software that links a bank trust department trading desk with broker-dealers.

The interim final rules provide a detail definition of "sales compensation." Specifically, "sales compensation" is:

- A fee for effecting a transaction in securities that is not a flat or capped per order processing fee equal to not more than the cost incurred by the bank in connection with executing securities transactions for trustee and fiduciary customers;

- Compensation that if paid to a broker or dealer would be payment for order flow;[14]

---

[13] Conf. Rep. 106-434, 106th Cong. 1st Sess. at 164 (1999)("[T]he SEC…[is] not [to] disturb traditional bank trust activities under this [the trust and fiduciary] provision.").

[14] "Payment for order flow" is a defined term under the Commission's rules. See Section Rule 10b-10, 17 CFR Section 240.10b-10.

- A finders' fee received in connection with a securities transaction or account, except a finders' fee does not include a referral fee permissible under the networking exception;

- A fee paid for an offering of securities that is not received directly from a customer or beneficiary, or directly from the assets of the trust or fiduciary account;

- A fee paid pursuant to a Rule 12b-1 plan under the Investment Company Act of 1940; or

- A fee paid by an investment company for personal service or for the maintenance of shareholder accounts, but does not include certain shareholder servicing fees that are not part of a 12b-1 plan.[15]

Finally, "unrelated compensation" is compensation that does not fall within the definitions of either "sales compensation" or "relationship compensation." As such, it must be factored out of any analysis of whether relationship compensation exceeds sales compensation.

The Commission has taken what should be a fairly simple test requiring relationship compensation to outweigh or exceed sales compensation and, instead, made it one that is overly complex and burdensome. What should take a paragraph to explain has taken 11 pages of narrative text. The regulatory burdens associated with this test are enormous. We highlight below just some of those burdens.

It is not uncommon for bank trust and fiduciary departments to be compensated for fiduciary services provided to one account from another trust or fiduciary account or from customers other than the account beneficiary. For example, 401(k) plan sponsors often negotiate for bank trustees to be compensated through the use of 12b-1, shareholder servicing fees, sub-transfer fees, finders fees and/or referral fees. These fees are paid by the mutual fund complexes in which the plan assets are invested. As a consequence they cannot be counted as "relationship compensation," yet this compensation may be the only compensation received by the bank on this particular account.

Continuing the example above, the interim final rules provide that, other than the sub-transfer fees, all the other fees would be considered "sales compensation." Sub-transfer fees would be classified as "unrelated compensation" and so could not form the denominator against which all "sales compensation" would be measured. Without any "relationship compensation" to measure "sales compensation" against, irrespective of whether "sales compensation" received

---

[15] Rule 3b-17(j). Specifically, "sales compensation" would not include fees paid to banks by mutual funds for providing transfer agent and subtranser agent services; aggregating and processing purchase and redemption orders; providing beneficial owners with statements showing their positions in the investment company; processing dividend payments; providing subaccounting services for shares in the investment company held beneficially; forwarding shareholder communications, such as proxies, shareholder reports, dividend and tax notices, and updating prospectuses to beneficial owners; or receiving, tabulating and transmitting proxies executed by beneficial owners. Compensation received for these services would be considered "unrelated compensation."

is 15 basis points or 50 basis points, the account would be in violation of the "chiefly compensated" test.

Companies that sponsor employee benefit plans for their employees like these fee arrangements. For many small employers, it is the only way they can afford to offer their employees access to 401(k) plans. For large employers it creates other issues. If these expenses were not paid through 12b-1 or shareholder servicing fees, the plan's trustee or recordkeeper would, on a daily basis, have to calculate a unit value for each investment option under the plan, deducting from the NAV of the investment option the proportionate trustee and recordkeeping charges for the day. This would be incredibly expensive. Plan sponsors understand prices quoted in an all-in or NAV basis rather than a separate line disclosure for trustee services provided. Moreover, prospectus disclosure of fees is more easily understood by plan participants.

Requiring "relationship compensation" to be paid out of fiduciary assets or to be paid directly by the customer or beneficiary is not required by Title II. Nowhere in the trust and fiduciary exception is there a suggestion that compensation must be paid from a particular source in order for it to be permissible under the "chiefly compensated" standard. Moreover, overlaying a "source" requirement on the "chiefly compensated" test effectively would deny many consumers the ability to participate in their employers' employee benefit plans when those plans are trusteed by banks.

The Commission has also added undue complexity to the term "flat or capped per order processing fee." The statute provides that a flat or capped per order processing fee must be equal to the cost incurred by the bank in connection with executing securities transactions for trust and fiduciary accounts. To determine "cost" the Commission tells us, we cannot include salaries of trust department personnel involved with executing the securities transaction unless that employee is working on a trading desk exclusively dedicated to trust and fiduciary customers.[16]

The exclusivity requirement is nowhere to be found in Title II. Nor is it a requirement with which the banking industry can easily comply. Trade execution functions are generally consolidated into one central place. Consolidation allows trades to be conducted on a more economic basis and ensures that trades made are not improperly allocated among the various accounts serviced by the bank and its affiliates. Because that desk will often perform trade execution functions for bank affiliates, as well as for the bank trust department, exclusivity cannot be assured and thus costs associated with these employee salaries cannot be factored into the cost of executing securities transactions.[17]

---

[16] The Commission also states that employee incentive compensation could not be included in determining costs associated with executing securities transactions. As we discuss infra, we have significant concerns regarding the Commission's characterization of referral fee and bonus programs.

[17] The fact that banks' trade execution facilities are consolidated at a centralized desk, often times located outside the bank in a registered investment advisory affiliate, or that bank fiduciaries find it more economical to outsource certain trust back office functions will also cause many banks to be unable to comply with yet another Commission imposed requirement under the trust and fiduciary exception. Specifically, Section 3(a)(4)(B)(ii) of the statute excepts banks that act as trustees or fiduciaries from the definition of "broker," if, among other things, "[t]he bank … effects transactions in a fiduciary capacity in a department that is regularly examined by bank examiners for compliance with fiduciary principles and standards." The Commission has interpreted "the regularly examined by

We also do not agree with the Commission's determination that dedicated resources should not include the cost of shared resources, general overhead allocation or a return on capital. Nowhere in the statute is there a suggestion that banks should have to perform these services at a loss. All costs associated with executing a securities transaction should be properly included in any cost determination. The ABA and ABASA strongly urge the Commission to eliminate the exclusivity requirement it has imposed on flat or capped per order processing fees—fees that are specifically permissible under Title II.

The Commission characterizes 12b-1 and shareholder servicing fees as "sales compensation." The ABA and ABASA disagree with that characterization. As previously discussed, the only fees received on a fiduciary account frequently will be the fees paid by mutual fund companies. These fee arrangements have been allowed by the Department of Labor.[18] Extensive disclosure concerning these fee arrangements is given to bank fiduciary customers. Nevertheless because the Commission has characterized these fees as "sales compensation," accounts for which the bank only receives 12b-1 and shareholder servicing fees from mutual funds will not be able to pass the "chiefly compensated" test. In order "to fix the problem" and to avoid having to move the account to a registered broker-dealer, banks will be forced to charge plan sponsors directly for the costs associated with providing these services.[19]

---

bank examiners for compliance with fiduciary principles and standards" to require that all of the following activities must be examined by bank fiduciary examiners in order to qualify for the exception:

- Identifying potential purchasers of securities;
- Screening potential participants in a transaction for creditworthiness;
- Soliciting securities transactions;
- Routing or matching orders, or facilitating the execution of a securities transaction;
- Handling customer funds and securities; and
- Preparing and sending transactions confirmations.

The Commission's soup to nuts approach regarding what fiduciary activities must be examined for fiduciary compliance is an overly restrictive reading of the statute. It also ignores that bank trust department frequently delegate or outsource certain functions to other bank departments, affiliates and even third parties, as permitted under applicable banking regulations. See Regulation 9.4, 12 CFR 9.4. While these providers frequently may be examined by bank examiners or even Commission inspection staff, they will not always be regularly examined for compliance with fiduciary principles.

[18] Advisory Opinions 97-15A and 97-16A (May 22, 1997).

[19] It is our understanding that the term "administrative fees" was specifically added to Paragraph 3(a)(4)B)(ii)(I) of Title II in order to make clear that non-distribution shareholder servicing fees are a form of permissible compensation under the exception. Consequently, the ABA and ABASA strongly agree with the banking regulators' position that these fees should be considered "relationship compensation" not "sales compensation." See Letter to Jonathan G. Katz, Secretary, Securities and Exchange Commission, from Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency, dated June 29, 2001 (hereinafter cited as "the regulators' letter).

Finally, those shareholder servicing fees that the Commission has specifically exempted from the definition of "sales compensation" under new Rule 3b-17(j)(6)(i)-(vii) should be treated as "relationship compensation," not unrelated compensation.

2. "Chiefly" should be calculated on a line-of-business basis.

Calculation of chiefly on an account-by-account basis would require banks to perform yearly analyses of fees charged to over 19 million accounts valued at over $22 trillion.[20] On the other hand, a line-of-business calculation would comport with current bank practices, systems capabilities, and regulatory reporting requirements; would not result in increased regulatory burden for bank trust and fiduciary departments; and would be consistent with Congressional purposes in enacting the exemption. We urge the Commission to reconsider its decision to require account-by-account calculations.

Banks and regulators use line-of-business in order to track fiduciary fees, manage fiduciary business lines, and report fiduciary business to bank regulators. Specifically, banks and trust companies generally charge fees for fiduciary services according to fee schedules that vary from business line to business line.

In addition, many bank trust departments and trust companies currently generate internal tracking reports along lines of business. For example, bank trust departments generate monthly management reports that track, on a business-line basis, revenues earned and expenses incurred. Finally, bank regulatory reports also require income earned by bank trust departments to be reported on a line-of-business basis.[21] In short, fees are generally tracked and aggregated on a line-of-business basis, and not on the more "granular" basis of types of fees charged to individual accounts.

Making the "chiefly" calculation on a more detailed or "granular" basis, would, in many cases, be extremely burdensome and practically unworkable. As previously outlined, expensive new software would have to be developed and installed; systems would have to be substantially reconfigured; and such fine-tuned reporting would become more complex and burdensome.

More importantly, even if a bank could afford the necessary software systems, it is highly likely that at least one account at every bank would not comply with the "chiefly compensated" standard. This is so because the Commission's rule contemplates that "chiefly compensated" will be analyzed on a "look-back" basis. Unintentional violations of the "chiefly compensated" standard would be discovered only after they had occurred.[22] In order to avoid potentially operating as an unregistered broker-dealer, the banking industry would be forced to move its traditional trust and fiduciary business to an affiliate broker-dealer--a result the Congress

---

[20] Federal Financial Institutions Examination Council, Trust Assets of Financial Institutions –1999, at 8 [hereinafter cited as "FFIEC"].

[21] See, e.g., Schedule E to the Annual Report of Trust Assets (Form FFIEC 001); Consolidated Reports of Condition and Income (Quarterly Call Reports)(Form FFIEC 041).

[22] It is for this reason we support the bank regulators request that the Commission provide for a cure mechanism that will allow banks a reasonable period of time to bring their operations into compliance with the Commission rules. See the regulators' letter at n. 19.

specifically sought to avoid.[23] It is also uncertain how such accounts could be pushed out of the bank since state law generally does not confer trust powers on broker-dealers.

Compliance with the "chiefly compensated" standard when calculated on an account-by-account basis is impossible when a bank and a customer negotiate fees. Negotiated fees often occur when a customer has several accounts with the institution or the account has significant assets. For example, the chief executive of a corporation may have his personal deposit accounts, mortgage accounts, lines-of-credit, trust accounts for himself, his wife and his two children with the bank. In addition, he might have a personal securities trading account with the bank's broker-dealer affiliate. His insurance needs may be met by the bank's insurance affiliate. Individual members of his family may also have separate accounts with the bank and its affiliates. Finally, the corporation of which he is chief executive may have its cash management, and credit needs serviced by the bank and its affiliates. Fees for all of these accounts are negotiated and it is very possible that on the basis of fees earned on other accounts the bank's investment management fee for the customer's trust and fiduciary accounts will be waived. The only fees earned by the bank on those trust and fiduciary accounts may be 12b-1 fees received from the various mutual funds in which fiduciary assets are invested. Because the Commission has classified 12b-1 fees as sales compensation, those accounts will not "pass" the chiefly compensated test. Yet, if the related trust accounts had been analyzed on a line-of-business basis, i.e., all the bank's personal trust accounts analyzed together, the bank undoubtedly would have passed the test.

The Commission has sought suggestions as to how aggregation could be accomplished. Obviously, taxpayer identification numbers or TINs and employer identification numbers or EINs could be used to identify linked accounts. Unfortunately, TINs and EINs will not work where account fees have been negotiated on the basis of several family member accounts or on the basis of individual and company accounts. Even a corporation has a different EIN than its 401(k) and defined benefit plans, each of which have their own EIN.

Nor is it feasible for bank trustees to renegotiate plan fees in order to come within the "chiefly compensated" test. The employee benefit market has moved to compensation arrangements whereby bank trustee fees are paid by mutual funds rather than the plan sponsor. It has done so with the concurrence of the Department of Labor as to the acceptability of these fee arrangements.[24] Moreover, plan sponsors prefer these fee arrangements. For many small employers, it is the only way they can afford to offer their employees access to a 401(k) plan. Consequently, absent any changes in the Commission's rules requiring "chiefly compensated" to be calculated on an account-by-account basis, banks will be forced to move their employee benefit business to an affiliated broker-dealer. Plans and plan participants could find themselves without coverage should a community bank determine not to set up an affiliated brokerage firm. And, of course, the difficulty in moving fiduciary business to an affiliated broker-dealer is, compounded by the fact that state law generally does not permit broker-dealers to serve as trustees.

---

[23] Conf. Rep. 106-434, 106th Cong. 1st Sess. at 164 (1999)("[T]he SEC…[is] not [to] disturb traditional bank trust activities under this [the trust and fiduciary] exception.").

[24] See n. 18 supra.

We recognize that that Commission has provided an exemption from the account-by-account review process for those banks that are almost entirely compensated by relationship compensation. Specifically, new Rule 3a4-2 would permit a bank to calculate "chiefly compensated" on a department-wide basis if its sales compensation is less than 10% of relationship compensation. Without even addressing the myriad of other conditions to this exemption, so many that the banking industry generally believes the exception is of little value, it is clear that banks with any significant degree of employee benefit business will be unable to use the exemption.

Moreover, we note that nothing in the statutory language creating the trust and fiduciary exception requires calculations to be made on other than a line-of-business basis. The purpose of the exception is to allow banks to keep in the bank the types of trust and fiduciary activities that banks have engaged in for many, many years, even where a substantial portion of those activities could involve fees that would otherwise trigger broker registration requirements.[25] The Congress recognized that, unlike several other push-out exceptions, where banks conduct securities transactions in their fiduciary capacity they are subject to an entirely separate scheme of bank fiduciary regulation. In that context, where customers have alternative regulatory protections, the statute expressly recognizes that securities activities ought to be permissible in the bank even where there are significant amounts of transaction-based compensation. Of course, the "chiefly" language, along with the requirements of separate broker-dealer execution of securities trades resulting from fiduciary activities and the prohibition on brokerage advertising, ensures that the trust exception may not be used simply to transfer a full-scale securities brokerage operation into a trust department to evade Commission regulation.

Our members believe very strongly that line-of-business reporting should be permitted to make the necessary "chiefly" calculation. Such reporting would not allow full-service securities firms to evade Commission regulation by transferring their businesses *in toto* to a bank's trust department. No evasion of fiduciary regulation of these activities could occur, as such regulation is a condition of this exception. And, finally, there would not be imposed the kind of regulatory burden that could, as a practical matter for many banks, require the very push-out of customary bank fiduciary activities that the Congress expressly sought to avoid.

3. <u>The exemption from account-by-account calculation is both unnecessary and unworkable.</u>

As noted above, the Commission has provided in Rule 3a4-2 an exemption from calculating "chiefly" on an account-by-account basis. The exemption permits a bank to calculate "chiefly" on a line-of-business basis if sales compensation for the trust department is less than 10% of the total amount of relationship compensation. The Congress did not intend for "chiefly" to be analyzed on an account-by-account basis and, thus, this exemption is totally unnecessary. Moreover, the exemption contains so many conditions and restrictions as to make it unworkable.

Specifically, the exemption requires the following:

[25] Conf. Rep. 106-434, 106th Cong. 1st Sess. at 164 (1999) (Traditional trust activities are not to be disturbed.)

- Compensation from accounts that do not hold securities cannot be included in the 10% calculation and, consequently, all accounts without securities at the time the calculation is made must be removed from consideration;

- Compensation received for activities covered by another statutory exception or regulatory exemption must not be included in the 10% calculation. In addition, any unrelated compensation received cannot be included in the calculation.[26] As a result, each trust and fiduciary account will have to be scrubbed to determine whether compensation received is unrelated or can be claimed under another exception or exemption.

- The bank must also maintain procedures reasonably designed to ensure compliance with the "chiefly compensated" requirement of the trust and fiduciary exception. "Chiefly compensated" must be analyzed when:

  - A trust or fiduciary account is opened;

  - The compensation arrangement for the account is changed;

  - Sales compensation received from the account is reviewed by the bank for purposes of determining an employee's compensation.

Many of our members believe that the exemption is more illusory than real because each account will have to be analyzed in order to satisfy the exemption's many conditions.

B. The Congress intended that all bank trustees, whether or not they exercise investment discretion, continue to operate within the bank, protected under Title II's Trust and Fiduciary Exception.

The Act provides that banks that act in either "a trustee capacity" or "a fiduciary capacity" are excepted from the definition of broker. In response to certain inquiries, the Commission has determined to address three narrow situations involving accounts where trustee banks take direction concerning the investment of fiduciary assets from persons outside of the bank. Specifically, new Rule 3b-17(k) defines "trustee capacity" as including "an indenture trustee or a trustee for a tax-deferred account described in Sections 401(a), 408, and 408(A) under subchapter D and in Section 457 under subchapter E of the Internal Revenue Code…."

While we agree with the Commission's determination in these three specific instances, we are concerned about the legal uncertainty created by its silence with respect to other accounts for which banks and trust companies serve as directed trustees. The Congress clearly intended that the statutory exception reach all banks executing transactions in a trustee capacity and we urge the Commission to acknowledge this fact.

---

[26] "Unrelated compensation" is compensation that does not fall within the definition of either "sales compensation" or "relationship compensation." See discussion supra at 5-9. "Unrelated compensation" cannot be used when calculating whether the "chiefly compensated" test has been satisfied.

In construing the meaning of a statute, we are directed to the plain meaning of the statute in question.[27] We need look no farther than the definition of "fiduciary capacity" provided under Title II.

Paragraph 3(a)(4)(D) defines "fiduciary capacity" as—

(i) in the capacity as trustee, executor, administrator, registrar of stocks and bonds, transfer agent, guardian, assignee, receiver, or custodian under a uniform gift to minor act, or as an investment adviser if the bank receives a fee for its investment advice;

(ii) in any capacity in which the bank possesses investment discretion on behalf of another; or

(iii) in any other similar capacity.[28]

Thus, under a literal reading of the statute, a "trustee" need not possess investment discretion in order to come within the definition of "fiduciary capacity." "Investment discretion" is needed only when claiming fiduciary capacity status under clause (ii). By specifying that banks that effect securities transactions in a trustee capacity will be excepted from the definition of broker, the Congress clearly meant that the status of bank trustee, with the concomitant obligations under applicable law, was sufficient to come within the exception.

Consequently, the ABA and ABASA wholeheartedly agree with the Commission that indenture trustees and trustees for traditional and Roth IRAs, 457 plans, defined benefit and defined contribution plans are trustees within the meaning of the statutory exception even when they take investment direction or orders from trust beneficiaries or other third parties. The Congress in providing an exception for banks effecting transactions in a trustee capacity did not distinguish between those trust banks exercising investment discretion and those taking investment direction from third parties.

Over 2,200 bank and trust companies hold over $4 trillion in assets in over 6 million non-discretionary employee benefit and personal trust accounts for which these institutions serve as trustee.[29] While the vast majority of those accounts do involve employee benefit trusts and thus include within their numbers IRA accounts, 457 plans, defined benefit and defined contribution plans, and welfare benefit trusts, such as VEBAs, hundreds of billions of dollars in personal trust

---

[27] 2A N. Singer, Sutherland on Statutory Construction, Section 46.01 (6th ed. 2000).

[28] The Commission has identified several other capacities that, while not expressly set forth in Paragraph 3(a)(4)(D), should be covered by subparagraph (iii) of the fiduciary and trust exception. These capacities include personal representative, conservator, custodial trustee, and custodians or conservators under the Uniform Transfers to Minors Act. The ABA and ABASA support the Commission's determinations in this regard.

[29] FFIEC at 9. This same data indicates that over 643 banks and trust companies served as bond trustees for over 138,000 corporate and municipal issues with over $6 trillion of outstanding bonds. FFIEC at 97-98. The data is not further broken down, however, to indicate discretionary and non-discretionary corporate trusteeships.

directed accounts arguably remains outside the definition of "trustee capacity" found in new Rule 3b-17(k). Examples of these accounts would include personal trust accounts, charitable foundation accounts, rabbi and secular trusts, and insurance trusts.

These accounts form the cornerstone of business administered by bank trust departments and, as traditional bank trust activities, the Congress intended that these activities remain within the bank. As the Senate Banking Committee made clear, "[b]anks are uniquely qualified to provide these [trust] services and have done so without any problems for years. Banks provided trust services under the strict mandates of State trust and fiduciary law without problems long before Glass-Steagall was enacted; there is no compelling policy reason for changing Federal regulation of bank trust departments, solely because Glass-Steagall is being modified."[30] Moreover, the House and Senate Conferees ratified this view when stating their expectation that "the SEC … not disturb traditional bank trust activities under this [the trust and fiduciary] provision."[31]

The ABA and ABASA recommend that the Commission make clear that all directed trust accounts fall within the meaning of "trustee capacity." This can be accomplished either by specifically adding the accounts listed above, as well as all similar types of accounts, to the definition of "trustee capacity" in Rule 3b-17(k). Or, alternatively, and preferably from the industry's point of view, drop the definition of "trustee capacity" in the Rule 3b-17 and make clear in the narrative portion of the subsequent release that any bank or trust company that assumes the mantle of a trustee is, when effecting transactions in securities, doing so in a trustee capacity and thus comes within the Act's trust and fiduciary exception.[32]

Should the Commission determine to go forward with Rule 3b-17(k), we would offer the following suggestions for clarifying the definitions of indenture trustee and trustee for a tax-deferred account.

1. Indenture Trustees

As outlined above, new Rule 3b-17(k) provides that indenture trustees come within the definition of "trustee capacity." Paragraph (c) of Rule 3b-17 defines "indenture trustee" as "any trustee for an indenture to which the definition given in Section 303 of the Trust Indenture Act of 1939 applies, and any trustee for an indenture to which the definition in Section 303 of the Trust Indenture Act of 1939 would apply but for an exemption from qualification pursuant to Section 304 of the Trust Indenture Act of 1939." This definition would appear to capture the bulk of corporate and municipal bonds for which banks serve as bond trustees, including certain resales of securities pursuant to Rule 144A.

---

[30] S. Rep. No. 106-44, 106th Cong. 1st Sess. at 10 (1999). See also S. Rep. No. 105-336, 105th Cong., 2nd Sess. at 10 (1998).

[31] Conf. Rep. 106-434, 106th Cong. 1st Sess. at 164 (1999).

[32] Our preference for eliminating the definition of "trustee capacity" under new Rule 3b-17(k) is based on our concern that subsequent Commissions and staff may determine to narrow by regulation or no-action guidance the very limited definition of "trustee capacity" now in place. In addition, we are convinced that the term "trustee" on its face is clear and unambiguous and needs no further explanation.

While the Commission has endeavored to draft as broad a definition as possible, it should be noted that trustee appointive documents are not limited to indentures. Appointive documents can include pooling and servicing agreements, trust agreements, bond resolutions, and mortgages. Additionally, trustee duties are specified in numerous ancillary transaction documents including loan agreements, servicing agreements, tax exemption agreements, credit enhancement contracts, and customer investment contracts. Consequently, it would be helpful if the definition of "indenture trustee" reflected the fact that trust appointive documents are not limited to indentures.

We suggest that the definition of indenture trustee be reframed in as broad a manner as possible so as not to exclude either indenture trustees operating under appointive documents other than indentures or indenture trustees serving on issues or transactions that may not be captured under either Sections 303 or 304 of the Trust Indenture Act. One possible suggestion would be to revise the definition of indenture trustee to provide the following: "The bank effects transactions as a trustee (including as a successor trustee) under an indenture agreement, trust agreement, lease, or similar financing agreement for debt securities or other forms of indebtedness."

We also note that many of our members have expressed concern that by specifying that indenture trustees do fall within the definition of trustee capacity, the Commission may be signaling that where the bank performs as an agent, i.e., paying or escrow agent, the bank may be functioning as a broker requiring registration. Agency appointments such as these are typically part of, or associated with, the corporate trust business. The bank, as agent, serves as a stakeholder of property for the benefit of two or more parties and, in this connection, performs duties which usually include directed investment and reinvestment. Clarification that these and other similar agency appointments[33] are excepted from the definition of brokerage under either the trust or custody exception would be most helpful.[34]

2. Trustees for Tax-Deferred Accounts

The list of tax-deferred accounts for which trustees may take direction and still satisfy the definition of " trustee capacity" under new Rule 3b-17(k) should be expanded to include accounts created under plans offered to employees of tax-exempt organizations or employees of certain education organizations under authority of Section 403(b) of the Internal Revenue Code ("IRC"). An organization that is tax-exempt under Section 501(c)(3) of the IRC ("charitable organizations") may offer a 403(b) plan to its employees. In addition, certain state colleges, universities and other similar educational organizations and cooperative hospitals may offer these plans to their employees. These plans are not qualified under Section 401(a) of the IRC

[33] Other agency capacities in which directed investment and reinvestment activities may occur include distribution agent, collateral agent, custodian for mortgage loan files, and as exchange accommodation titleholder or qualified intermediary in like kind exchange transactions under Section 1031 of the Internal Revenue Code ("IRC").

[34] Securities activities involving escrow agents arguably are protected under division (dd) of the safekeeping and custody exemption. That provision provides that when the bank "holds securities pledged by a customer to another person," it will be protected from being pushed-out of the bank and into a registered broker-dealer. See Paragraph 3(a)(4)(B)(viii) of Title II.

nor are they traditional or Roth IRAs under Sections 408 and 408A of the IRC and, hence, would not be protected under new Rule 3b-17(k). Banks serve as both trustees and custodians to these plans. Bank custodians holding 403(b) assets are treated as a trustee pursuant to IRC Section 401(f).

C. All investment advisory services, even those that provide periodic investment advice, are fiduciary services under the Trust and Fiduciary exception and, as such, may continue to be conducted in the bank's trust department.

As noted above, paragraph 3(a)(4)(D) defines fiduciary capacity to include "investment adviser if the bank receives a fee for its investment advice." The Commission has determined that further refinement of the term is required and has added two additional requirements. First, the advice given to a customer's account must be "continuous and regular," which the Commission advises is something more than "episodic" or "periodic." Second, the bank owes a duty of loyalty to make full and fair disclosure to the customer of all material facts relating to conflicts.[35] The ABA and ABASA strongly believe there is no basis for the Commission to narrow what the Congress specifically provided, namely that all fiduciary investment advisory activities are, without exception, protected by the trust and fiduciary push-out provision.

The Commission justifies the need for the advice to be "continuous and regular" on the basis that banks need further clarification of the term "investment adviser." "[W]e are providing guidance to aid banks in determining which advisory relationships to non-discretionary accounts are covered by the fiduciary category of "investment adviser if the bank receives a fee for its investment advice." 66 Federal Register at 27770. Guidance in this area is unnecessary, however. Over the years, bank regulators have provided regulated fiduciary institutions with sufficient guidance concerning investment advisory activities. Banks need no additional guidance to determine which investment advisory accounts fall within the trust exception.

As the Commission is aware, the definition of "fiduciary capacity" contained in Paragraph 3(a)(4)(D) was lifted verbatim from regulations governing the fiduciary activities of national banks issued by the Office of the Comptroller of the Currency ("OCC").[36] Those regulations contain a definition of "fiduciary capacity" that, among other things, codified a long-standing position of the OCC that investment advisory activities are fiduciary in nature.[37] Banks have long operated with the clear knowledge and understanding of what type of investment advisory activities are considered fiduciary. The Commission should not disturb long-settled interpretations of trust and fiduciary law by adding new and additional requirements to a federal broker-dealer registration requirement. As the Conferees clearly warned, "[T]he SEC …[is] not [to] disturb traditional bank trust activities…."[38]

---

[35] New Rule 3b-17(d), 17 CFR 240.3b-17(d)

[36] Regulation 9.2(e), 12 CFR 9.2(e); 61 Fed Reg. 68543, 68545 (1986) see also 12 CFR 9.101.

[37] See Comptroller's Handbook for Fiduciary Activities, Section 9.2100 at 225 (1990).

[38] Conf. Rep. 106-434, 106th Cong. 1st Sess. at 164 (1999).

In determining the intent of the legislature, it is appropriate to look to events occurring immediately prior to the time an act becomes law.[39] In October, 1996, the Congress adopted the National Securities Markets Improvement Act ("NSMIA")[40] which allocated responsibility between state and federal securities regulators for supervising investment advisers. That Act added new Section 203A to the Investment Advisers Act, 15 U.S.C. 80b-3A. Section 203A employs the concept of "continuous and regular" in determining which advisers will be registered with, and, thus, regulated by, the Commission. In the release accompanying the interim final rules, the Commission specifically notes that the concept of "continuous and regular" is borrowed from Section 203A.

Passage of NSMIA was closely followed by the OCC's adoption of a revised Regulation 9 governing fiduciary activities of national banks. Revised Regulation 9 contained a definition of "fiduciary capacity" and it was, shortly thereafter, that that same definition found its way into legislation then-being considered by the Congress.[41] That legislation served as the base text for legislation that the 106th Congress eventually enacted into law as the Gramm-Leach-Bliley Act. Because Congress did not add a "continuous and regular" requirement when defining "fiduciary capacity" to include "investment advice for a fee," we can infer that Congress was aware of the "continous and regular" requirement it placed in NSMIA only three years before but, nevertheless, intended not to import that term into Title II. We can also assume that the Congress chose to use precisely the same terms as used in federal banking regulations in order to assure that the described fiduciary activities were examined by banking regulators, as required by the exception itself.[42]

Unfortunately, the Commission's action of adding "continuous and regular" to the trust and fiduciary exception from broker-dealer registration potentially places bank fiduciaries, unable to comply with the Commission's interpretation of "continuous and regular," in the untenable position of being regulated by both the OCC and the Commission. To avoid such a result, banks will be forced to move their traditional investment advisory activities out of the bank and into a registered broker-dealer—an action the Congress specifically counseled against in the House and Senate Conference Report.[43]

Moreover, we note that the concept of "continuous and regular" is not determinative under the federal securities laws as to whether an entity is functioning as an investment adviser. Rather the concept is used as a condition to federal, as opposed to state, registration. See Section 203A of the Investment Advisers Act.

---

[39] 2A N. Singer, Sutherland on Statutory Construction, Section 48.04 (6th ed. 2000).

[40] Pub. L. No. 104-290, 110 Stat. 3416 (1996).

[41] H.R. 10, 105th Cong., 2nd Sess. (1998). In fact, at the time, it was made clear during discussions with the Commission staff, Treasury officials, and banking industry representatives that the definition of "fiduciary capacity" was derived from the OCC's Regulation 9.

[42] The trust and fiduciary exception requires that "The bank …, effects transactions in a fiduciary capacity in its trust department or other department that is regularly examined by bank examiners for compliance with fiduciary principles and standards,…." See Paragraph 3(a)(4)(B)(ii).

[43] Conf. Rep. 106-434, 106th Cong. 1st Sess. at 164 (1999).

Similarly, the duty of loyalty requirement imposed by the interim final rules is not determinative of whether an entity or individual is functioning as an investment adviser. This is true if we look to the federal securities laws, applicable banking laws or state common and decisional law.

Banks acting in a fiduciary capacity are subject to a range of fiduciary obligations, including the duty of loyalty. The duty of loyalty is derived from bank regulation, ERISA, the Internal Revenue Code, state statutes, and common and case law. For example, under the Employment Retirement Income Security Act ('ERISA"), the duty of loyalty has been subject to years of study and interpretation[44] that banks and other employee benefit trustees rely upon. This duty emphasizes that trust assets are maintained for the exclusive benefit of beneficiaries. No need exists to place on bank fiduciaries yet another duty of loyalty emanating from the federal securities laws.

II. Safekeeping and Custody Exception

A. Order-taking, including order-taking on behalf of self-directed IRA and 401(k) accounts, is integral to bank custodial activities and, as such, is protected under Title II's custodial exception.

The Congress determined in the Gramm-Leach-Bliley Act that a bank that engages in safekeeping and custody activities in accordance with the conditions outlined in clause (viii) of subparagraph (B) will not be considered a broker within the meaning of Section 3(a)(4)(A) of the Securities Exchange Act of 1934.[45] As demonstrated below, order taking clearly comes within the ambit of "custody services" and, contrary to the Commission's position, should not be "pushed out" of the bank.

Order taking is most easily understood in the context of self-directed individual retirement accounts ("IRAs") and 401(k) and other defined contribution plans. Generally speaking, employees who have contributed over the years to their company-sponsored 401(k) plans or participated in their employer-funded defined contribution plans will, upon leaving their jobs, opt to roll-over assets from their plans into IRA accounts. If employees have the time and inclination to direct their own investments, they will frequently choose to open self-directed IRA

---

[44] Section 404(a)(1)(A) of ERISA 29 U.S.C. 1001; DOL Reg. Section 2550.408c-2(b)(3); Advisory opinion 83-20A; Advisory opinion 86-001A, Advisory opinion 89-09A, Advisory opinion 93-06A.

[45] Clause (viii) provides that "[t]he bank, as part of customary banking activities—(aa) provides safekeeping or custody services with respect to securities, including the exercise of warrants and other rights on behalf of customers; (bb) facilitates the transfer of funds or securities, as a custodian or clearing agency in connection with the clearance and settlement of its customers' transactions in securities, (cc) effects securities lending or borrowing transactions with or on behalf of customers as part of services provided to customers pursuant to division (aa) or (bb) or invests cash collateral pledged in connection with such transactions; (dd) holds securities pledged by a customer to another person or securities subject to purchase or resale agreements involving a customer, or facilitates the pledging or transfer of such securities by book entry or as otherwise provided under applicable law, if the bank maintains records separately identifying the securities and the customer; or (ee) serves as custodian or provider of other related administrative services to any individual retirement account, pension, retirement, profit sharing, bonus, thrift savings, incentive or other similar benefit plan."

custodial accounts.[46] In this way, they can direct the custodian institution regarding the investment of their retirement assets.

Both banks and broker-dealers serve as custodians to self-directed IRA accounts. Employees and former employees frequently choose banks to serve as custodians to their IRA accounts on the basis of the strong capital supporting that institution as well as the convenience and comfort of dealing with a local institution.

Other times, an employer/plan sponsor will hire a bank as custodian to service the company's 401(k) or other defined contribution plan. Most often, those plans permit employee/plan participants to select investments from a range of options offered by the plan. Custodian banks effectuate securities trades only after taking employee/plan participants' investment orders.

Order taking is also offered as an adjunct to custodial services to high-net worth customers. High-net worth individuals generally seek a package of bank products and services, of which the custody account is just one. These customers rely on the fact that bank custodial activities are subject to frequent examination by the bank regulators for compliance with ERISA, the IRC and other bank regulatory guidance related to bank securities activities.

It is clear that in enacting the various exceptions from push-out, Congress intended that banks be permitted to engage directly in the bank in certain activities involving securities transactions in which banks have traditionally engaged. See Conf. Rep. 106-434. at 163-64 (November 2, 1999); S. Rep. No. 106-44, at 10 (April 28, 1999); Order taking or buying or selling securities at customer direction and as an adjunct to custody relationships has long been a custody service provided by banks. Recognized authorities in trust and fiduciary law tell us that custody services include safekeeping of securities; collecting income; collecting matured or called principal; notifying the customer of subscription rights; and **buying, selling**, receiving and delivering of securities on specific directions from the customer (emphasis added).[47]

The specific language of the exception further supports the conclusion that Congress intended to include all traditional custodial services within the safekeeping and custody exception by referencing safekeeping and custody services as part of customary banking activities. Who better than the bank regulators, the agencies charged by Congress with supervising banking organizations, should tell us what constitutes customary bank custodial activities? Bank regulatory guidance makes clear that order taking is a traditional component of bank custodial activities. See FDIC Trust Examination Manual, Vol.1 at 4-9 ("[F]or example, in the exercise of custodial duties involving securities, the bank may be required to…execute the

---

[46] Employees may also choose to open a self-directed IRA account where the bank or trust company serves as trustee. See discussion infra at 13-15. Order-taking when the bank serves as trustee is not at issue here.

[47] See the definition of custodian in Banking Terminology (2nd edition), a publication of the American Institute of Banking; the discussion of the responsibilities of a custodian in Trust Business, published by the American Institute of Banking in 1934; Section 8.1 of Scott on Trusts; FDIC Trust Examination Manual, Vol 1 at 4-9 (1997); Clarke, Zalaha, and Zinsser, The Trust Business at 67 (1988); Gregor, Trust Basics at 43 (1998); discussion of custodial accounts in Trust Audit Manual, (1976), a publication of the Bank Administration Institute; What a Trust Department Does at 34 (1940), a publication of Continental Illinois National Bank.

principal's orders to buy and sell agency property.") U.S. Department of the Treasury, Public Policy Aspects of Bank Securities Activities: An Issues Paper, at 5 (November 1975) ("In addition to this safe-keeping service [custodial account], the bank, for a fee, may also buy and sell securities at the direction of the customer….") We can assume the Congress understood this when approving the custody exception's "customary banking" language.

Indeed, even in testimony to the Congress, the Commission advocated on behalf of a custody exception narrowed to customary banking activities. "The Commission staff is concerned that the broad language in this [the custody] exemption could be interpreted to include activities beyond *customary banking activities."* Appendix to Testimony of SEC Chairman Arthur Levitt before the Subcommittee on Finance and Hazardous Materials of the House Committee on Commerce, July 17, 1997 (emphasis supplied) (hereinafter cited as "Appendix to Testimony of SEC Chairman Arthur Levitt"). Having argued in favor of a custody exception narrowed to customary banking activities, the Commission cannot now argue that the term "customary banking activities"—a term specifically embraced by the Commission in the context of the safekeeping and custody exception—does not include order taking.

Other provisions of the exception also lend support to the proposition that the Congress clearly understood that bank custodians customarily take direction regarding the purchase and sale of securities from individual clients. Section 3(a)(4)(C) directs banks and trust companies conducting securities transactions under the auspices of the safekeeping and custody exemption, as well as the trust and fiduciary and stock purchase plan exceptions, to transmit publicly traded security buy or sell orders to a registered broker-dealer for execution. Clearly, if banks were not taking orders from consumers, there would be no need for any legislative requirement to direct the transaction to a registered broker-dealer. Contrary to the Commission's argument, Paragraph (C) is not limited in its application; it applies to all activities exempt under the safekeeping and custody exception.[48]

We also note that division (ee) to the exception singles out one of the many types of accounts for which banks provide order-taking services, namely, individual retirement accounts or IRAs. Self-directed IRA custodial accounts were singled out for specialized treatment during the House and Senate conference process in order to make crystal clear that self-directed IRA activities involving securities would remain in the bank.[49] This action was viewed as necessary, despite the fact that the legislative history for both the 106th and 105th Congresses specifically addresses self-directed IRAs,[50] because the Commission's opposition to permitting banks to

---

[48] Despite comments to the contrary, the Commission implicitly agrees with this proposition. Otherwise, the Commission would not have agreed with the industry that Commission exemptive relief from Paragraph (C) was necessary in order to accommodate custodial purchases of mutual fund shares. See discussion infra at 31-32.

[49] See Summary of Provisions of Chairmen's Mark and Chairmen's Mark of the Gramm-Leach-Bliley Act, dated October 12, 1999. ("The limited [Title II] exemptions would cover transactions in connection with the following bank activities:… self-directed IRAs …).

[50] S. Rep. 106-44, 106th Cong. 1st Sess. at 10 (1999); S. Rep. No. 105-336, 105th Cong. 2d Sess. at 10 (1998). An earlier Committee report issued by the House Commerce Committee during the 105th Congress had suggested that self-directed IRA accounts were not protected under the push-out provisions thereby necessitating a rebuttal from the Senate Banking Committee during that same session of Congress. See H.R. Rep. No. 105-164, pt. 3, at 135 (1997).

service self-directed IRA accounts was well known.[51] In addition, various articles appearing in the press at the time questioned whether self-directed IRA accounts were adequately protected under the push-out exceptions then included in the bills under consideration by both legislative bodies.[52] To make absolutely clear that self-directed IRA custodial accounts were protected under the custody exception, new division (ee) was added.

Division (ee) recognizes that banks will take direction from bank customers. It does not contemplate that the bank as custodian or provider of services will become involved in the transaction only after the trade has been executed. Rather the self-directed IRA provision illustrates quite clearly that Congress understood and embraced the notion that banks would remain exempt from broker-dealer registration even if they took direction from an individual customer and transmitted that order to a broker-dealer for execution.

Despite overwhelming evidence to the contrary, the Commission nevertheless claims that "… the exception does not allow banks,…. accept orders to purchase and sell securities." Under the Commission's narrow interpretation of the custody exception, banks would be **prohibited** from taking orders from 401(k) plan participants, self-directed IRA customers, and many other consumers. Clearly, Congress could not have intended such a disruption to traditional bank custodial activities.

The Commission justifies its reading of the statute by claiming that if the order-taking function is not moved to a broker-dealer, bank custodial customers may be subject to sales practice abuses and confusion. In truth, however, these transactions are initiated by the consumer. No trades are solicited and none can be initiated absent the customer's authorization. Investment advice is not sought and none is given. Further consumer protection is provided by ERISA[53] and banking regulations that require bank securities trading policies and procedures to be established.[54] Subsumed within those trading practice procedures are requirements to establish equitable trade allocation policies. And because the transaction would be executed through a registered broker-dealer, compliance with best execution requirements imposed by the federal securities regulators is assured. In sum, current laws provide sufficient protection from abuses.

---

[51] See Appendix to Testimony of SEC Chairman Arthur Levitt at 3-4.

[52] Melanie L. Fein, *Comment: Is Reform Bill a Menace to Bank Retirement Plans?,* The American Banker, June 1, 1999, at 12; Sarah A. Miller, *Comment: Reform Won't Affect Pension Services*, The American Banker, June 18, 1999, at 9; Lee A Pickard, *Comment: House Version of Trust Bill Goes Too Far*, The American Banker, July 9, 1999, at 6.

[53] According to the DOL even in situations where an investment manager is appointed, the trustee continues to retain residual liability. The DOL notes that section 404(a)(1)(B) requires the "named fiduciary" appointing the investment manager to periodically monitor the activities of the investment manager with respect to the management of plan assets. See Letter from the DOL to Fandle, dated February 23, 1988; Letter from the DOL to Fandl, dated September 28, 1995.

[54] See, e.g., 12 CFR 12.7; Comptroller's Handbook on Conflicts of Interest, at 22 (June 2000); Comptroller's Handbook on Community Bank Fiduciary Activities Supervision, at 33 (December 1998).

Apparently in recognition of this fact, the Commission has chosen to provide two regulatory exemptions that would permit banks to engage in order-taking under the custody exception. While we appreciate the need for these regulatory exemptions given the SEC's narrow reading of Title II, the issue remains that if the Commission had embraced the clear Congressional intent behind the custody exception, no need for these regulatory exemptions would exist.[55]

B. The Commission's exemptions for order-taking activities do not reflect current industry practice and are, thus, unworkable.

New Rule 3a4-4, applicable only to small banks,[56] would allow order-taking in investment company securities for customers' tax-deferred custody accounts only. Rule 3a4-5 would permit all banks, large and small, to accept orders for securities safekeeping and custody accounts but only where the bank is not compensated for these transactions.

As we discuss below, the ABA and ABASA do not believe that these exemptions provide any degree of meaningful relief for banks, both large and small, engaged in order-taking activities. The exemptions are conditioned on so many restrictions—restrictions that do not reflect current realities of the custody business—as to render them unworkable.

One of the most troublesome exemptive conditions placed on banks providing order-taking services under Rule 3a4-5 is the inability to charge customers for services provided. While not prohibited from receiving any compensation, small banks are severely constrained under Rule 3a4-4 in the amount of revenue they can collect for providing order-taking services.[57]

We are unalterably opposed to the notion that in order to keep a legitimate customary banking activity in the bank, a bank must forego compensation. Nothing in the Gramm-Leach-Bliley Act suggests that restricting compensation received by banks for providing safekeeping and custody services is warranted.

Moreover, current bank practices would be severely impacted. Banks that provide order-taking capabilities to custodial accounts, including 401(k) plans and self-directed IRAs, charge transaction fees for effectuating customer orders. Unlike brokerage firms, however, banks generally charge a flat fee to effectuate the transaction, i.e., the fee is not dependent on the number of securities involved in the transaction. The order-taking exemptions would force banks to provide these services to many customers at a significant loss, raising serious safety and soundness concerns. These exemptions also prevent banks from establishing pricing structures that charge clients for the bank services they use.

---

[55] We are also concerned that a future Commission and staff, unaware of the legislative history behind the Gramm-Leach-Bliley Act, may choose to cut back significantly on, or, worse, repeal, these regulatory exemptions.

[56] We would submit that federal bank regulations, not regulations issued by the Small Business Administration ('SBA") to determine SBA program eligibility, are a better guide of small bank asset size. A small bank under regulations implementing the Community Reinvestment Act is defined as a bank with less that $250 million in total assets and either independent of, or affiliated with, a holding company of less than $1 billion in assets. See e.g., 12 CFR 345.12(t).

[57] Specifically, small banks would be permitted to collect compensation for order-taking activities so long as revenue received was less than 3% of its annual revenue.

Alternatively, of course, banks could move their order-taking activities to broker-dealer affiliates where order-taking compensation would not be similarly restricted by Commission rules. Many broker-dealer firms affiliated with banks have expressed concern about assuming order execution responsibilities for bank custodial accounts. Thousands of accounts would be opened under individual customer account names. Records for these accounts would have to be established and maintained. Compliance responsibilities would be expanded by the adding these accounts to the broker's book. Yet no assets would be held in the account as the actual custodial account and assets would remain in the bank.

The Commission argues that strict compensation limits are necessary because investor protections offered under the federal securities laws will not be available to consumers. Fiduciary protections are assured under the IRC.[58] In addition, bank custodial activities are subject to investor protections provided under the federal banking laws.[59]

We are equally concerned about several other conditions incorporated into the exemptions. These include the inability to have in the custody department dual employees—employees who are employed by both the bank and brokerage firm. Many bank employees of custodial departments also hold Series 6 or 7 licenses and are associated with either an affiliated or third-party brokerage firm. Bank employees find it useful to have a securities representative's license in order to serve retail customers with whom they may come into contact while performing their bank custodial responsibilities. For example, a bank custodian to an employee benefit plan will often send a bank employee to a plan sponsor's place of business in order to provide investment education to employee/plan participants on investment options offered under the firm's 401(k) plan. In this connection, it is not uncommon for employee/plan participants to approach bank custodial employees about investing after-tax or retail monies with the banking organization. In order to meet that individual's investment needs and not turn him away, the bank employee must doff his bank employee cap and serve the client in his capacity as registered representative. The exemptions would effectively prevent dual employees from offering holding company products and services in a seamless fashion and best serving these customers' investment needs.

The exemptions also dictate what investment products must be made available. For example, small banks, under Rule 3a4-4, are limited to providing order-taking services for clients seeking mutual funds only. No reason exists to prevent a bank from being able to service a tax-deferred account holding corporate debt or equity securities. This situation will often occur when an employee with a 401(k) plan option to invest in company stock rolls plan assets over to a self-directed IRA.

Finally, the employee compensation provisions contained in new Rule 3a4-5 are also quite troubling. Banks should be able to reward their employees for securing new custodial business.

---

[58] Section 401 (f) of the IRC. ("[A] custodial account….shall be treated as a qualified trust under this section.").

[59] <u>See</u> Interagency Statement, <u>supra</u> 12 CFR 12.7.

III. The Networking Exception

A. Under the interim final rules, bank referral fee programs will have to be reviewed and significantly revised.

The networking exception is the only push-out provision in which the Congress chose to address employee compensation.[60] Specifically, it provides that bank employees may not receive incentive compensation for any brokerage transactions but "may receive compensation for the referral of any customer if the compensation is a nominal one-time cash fee of a fixed dollar amount and the payment of the fee is not contingent on whether the referral results in a transaction."

In new Rule 3b-17(h), the Commission defines the term "referral" to mean a bank employee arranging a first securities-related contact between a registered broker-dealer and a bank customer. In addition, new Rule 3b-17(g) provides two alternative definitions of the term "nominal one-time cash fee of a fixed dollar amount." As discussed below, we believe these alternative definitions are not needed to effectuate compliance with the statute and, additionally, will pose significant compliance burdens for our members.[61]

Specifically, the new rule provides that a nominal one-time cash fee of a fixed dollar amount may be a payment that does not exceed one hour of the gross cash wages of the unregistered bank employee making the referral. The rule also provides that a nominal one-time cash fee of a fixed dollar amount may be a payment in the form of points in a system or program that covers a range of bank products and non-securities related services, where the points count toward a bonus that is cash or non-cash, if the points awarded for referrals involving securities are not greater than the points awarded for products or services not involving securities.

In addition, Rule 3b-17(g) requires that regardless of whether a cash or non-cash referral fee is paid, the payments may not be related to:

- The size, value, or completion of any securities transaction;
- The amount of securities-related assets gathered;
- The size or value of any customer's bank or securities account; or
- The customer's financial status.

Our members, banks and broker-dealers alike, have long operated their referral

[60] The networking exception permits bank employees to provide support services to third-party and affiliated broker-dealers in connection with the sale of securities to bank customers. In order to qualify for the exception, the networking services must satisfy a number of conditions including physical separation of brokerage and banking services, compliance with advertising conditions, disclosures, conditions on banks acting as carrying brokers, and employee compensation. See Paragraph 3(a)(4)(B)(i).

fee programs in compliance with all applicable regulatory guidance including guidance issued by the Commission applicable to broker-dealers operating on financial institution premises.[62] That guidance generally has permitted referral fee programs where:

- The fee is a nominal, fixed-dollar amount;
- The amount of the referral fee is unrelated to the execution of securities transactions or the volume of securities traded by the customer;
- The referral fee is determined and paid by the financial institution and not the broker-dealer;
- No more than one fee per customer may be paid; and
- Non-cash referral programs are structured similarly to cash referral programs.

These requirements have formed the framework for the development of many bank referral fee programs involving products and services other than securities. For example, the federal banking regulators, as directed by the Gramm-Leach-Bliley Act, recently adopted rules that required banks to adopt referral fee programs for insurance products that closely follow guidance given in the Interagency Statement on Retail Sales of Nondeposit Investment Products and Commission no-action letters.[63] Currently, bank compliance staff are reviewing and modifying, as necessary, their referral fee programs to reflect this recently issued regulatory guidance. It is unfair and extremely burdensome for the Commission to now rewrite the very rules that have served as the framework for all bank referral programs, especially as these revisions were never prescribed by the Congress.

We list below many of the significant requirements the Commission has added by way of the interim final rules to bank referral fee programs that will take considerable time and money to implement, including:

- Calculating a flat dollar amount for each employee based on their gross hourly wages;
- For salaried employees, calculating their hourly wage and setting an appropriate referral fee based on that wage;

---

[61] See, e.g., Chubb Securities Corp., 1993 SEC No-Act. LEXIS 1204 (Nov. 24, 1993); *Interagency Statement on Retail Sales of Non-deposit Investment Products*, NR 94-21, February 17, 1994; SR 94-11, February 17, 1994; FIL 9-94, February 17, 1994; OCC Bulletin 94-13 (February 24, 1994); FRB Examination Procedures for Retail Sales of Nondeposit Investment Products (May 31, 1994); FDIC Examination Procedures for Retail Nondeposit Investment Product Sales, FIL 48-97; 1997 FDIC Interp. Ltr. LEXIS 41 (May 7, 1997); FIL 80-98, 1998 FDIC Interp. Ltr. LEXIS 74 (July 16, 1998).

[62] See Consumer Protections for Depository Institution Sales of Insurance, 65 Fed. Reg. 75822 (2000); 66 Fed Reg. 15345 (2001). The effective date for these rules is October 1, 2001

- Tracking of salaries and gross hourly wages of all employees eligible for referral fee programs;

- Revising point programs to ensure that points paid for brokerage referrals receive the lowest point referrals of all products included in the point program, including points awarded for safety deposit boxes, savings accounts, checking accounts, etc.

- Reviewing all referral programs to ensure that the value of the securities account, the value of the customer's bank account, or the customer's financial status are not included in any established referral fee programs.

Moreover, the inability to pay the same referral fee to each employee performing the same function will negatively impact the ability of banks to instill a team approach to servicing customers. We also fear the confidentiality of employee salary information.

Alternatively, if a bank were to opt, under the interim final rules, to keep in place a referral fee program that pays one flat rate across-the-board to all employees, the lowest wage employee's hourly rate will serve as the benchmark for determining what is a nominal referral fee. Wichita, Kansas rates will control referrals in San Francisco, California for a large multi-state or national bank operation. Clearly basing "nominal" on an hourly wage rate is unworkable and we urge the Commission to provide the industry more flexibility in establishing referral fee programs.

The Commission also states that bonuses based on brokerage referrals fall within the compensation limits of the exception. Bonuses based on the overall profitability of the bank regardless of the contribution of employee or employees receiving the bonus are permissible, however. Unfortunately, rather than clarify under what circumstances bonuses will come within the networking exception's prohibition on the payment of incentive compensation to unlicensed individuals, this language has created a great deal of confusion among our members. Consequently, we urge the Commission to make clear that in discussing bonus plans in the interim final rules, the Commission intended only to advise that bonus plans should not be used as a conduit to pay transaction related compensation to unregistered employees.[63]

Finally, we do wish to applaud the Commission on a point of clarification made with respect to compensation arrangements between broker-dealers and banks. Specifically, the Commission stated that it continues to be permissible for a broker-dealer in a networking arrangement with a bank to make transaction-related payments to the bank for brokerage transactions conducted by the broker-dealer with the bank's customers. That proposition had previously been established in a series of Commission no-action letters. We are heartened to see it reaffirmed by the Commission.

IV. The Sweep Exception

A. The Congress intended to preserve the ability of banks to sweep deposit

[63] We note that discussions between ABA and ABASA representatives and Commission staff on bonus and referral fee programs has, to date, been productive and helpful.

accounts into money market mutual funds that do not charge sales loads.

Title II provides an exception from push-out for those banks that sweep on a nightly basis demand deposit balances out of the bank and into no-load money market mutual funds; the next day, the balances are swept back into the customer's deposit account to meet the daily transactions requirements.[64] These "sweep accounts" offer both commercial and retail customers the ability to make cash deposits productive and allow banks offering these services to compete against other financial services providers offering corporate cash management accounts that look and feel like checking accounts, but pay market rates of interest. Banks are legally prohibited from paying interest on demand deposit accounts.[65]

Interest in these sweep services is particularly strong with small business customers. To accommodate these customers, banks generally sweep customers funds into U.S. government securities[66] and money market mutual funds. Because money market mutual funds are securities, an exception from push-out is necessary. Indeed, 16 years ago, the Commission itself agreed that, if banks lost their blanket exception from broker-dealer registration under the federal securities laws, special protection would be needed for banks that sweep deposit balances into no-load money market mutual funds.[67]

In the interim final rules, the Commission has taken the position that a "no-load" money market mutual fund is a fund that is not subject to either a front-end or back-end load and the fund's total charges against net assets to provide for sales related expenses and/or service fees do *not* exceed 25 basis points. The Commission largely bases the second prong of its definition on advertising rules issued by the National Association of Securities Dealers ("NASD") in the early 1990s.[68]

While the industry is in agreement with the Commission on the first prong of its no-load definition, i.e., that no-load is generally understood to mean no front-end or back-end sales charges, we do not believe that the Congress intended to incorporate the NASD's advertising guidance into the concept of "no-load" as used in the Title II exception.[69] On this basis alone, the Commission should define no-load as meaning no sales loads or charges.

---

[64] Paragraph 3(a)(4)(B)(v) provides: "The bank effects transactions as part of a program for the investment or reinvestment of deposit funds into any no-load, open-end management investment company registered under the Investment Company Act of 1940 that holds itself out as a money market fund."

[65] See Section 19(i) of the Federal Reserve Act. Legislation has been introduced in the Congress that would allow banks to pay interest on corporate accounts. This legislation, the Small Business Interest Checking Act of 2001, H.R. 974, was approved by the House on April 3, 2001. H.R. 974 has been referred to the Senate Banking Committee.

[66] Sweep account services involving U.S. government securities would be protected from push-out under the exception for exempted securities which includes U.S. government securities. See Paragraph 3(a)(4)(B)(iii).

[67] See Rel. No. 34-22205, 50 Fed. Reg. 28394 (1985).

[68] NASD Rule 2830(d)(4); see also NASD Notice to Members 93-12.

[69] Our position with respect to the definition of "no-load" is equally applicable to the Commission's exemption, under new Rule 3a4-3, from the "chiefly" computation for indenture trustees. While we are supportive of the

Two of the primary legislators responsible for the passage of this historic legislation confirm the accuracy of our position. Specifically, Rep. Leach (R-IA), Chairman of the House Banking Committee at the time the Gramm-Leach-Bliley Act was approved by the House and signed into law, has indicated that "…it was the intent [of the Congress] that such term [no-load] be construed to ensure that existing bank sweep activities not be disturbed by the law." [70] The same notion of not changing or limiting existing bank activities was echoed by Senator Gramm (R-TX), Chairman of the Senate Banking Committee at the time the Gramm-Leach-Bliley Act was approved by the Senate and enacted into law.[71] Equally important is the fact that Chairman Leach rejected the NASD's no-load interpretation as "…not dispositive in determining whether a bank offering a money market sweep account should register as a broker-dealer." Chairman Leach concluded that "… the adoption of the NASD standard by the Commission in this situation would be inconsistent with the Congressional intent."

We also believe that it would be inaccurate to say that at the time the Gramm-Leach-Bliley Act was enacted into law it was generally understood that the Commission embraced the NASD's definition of "no-load." While it is true that a 1994 letter from the Director of the Division of Investment Management cited approvingly to the NASD's interpretation of the term "no-load,"[72] neither the Investment Company Act of 1940, the federal statute governing mutual funds, nor the Commission's regulations and forms promulgated thereunder, use the NASD's interpretation when referencing sales loads.[73] Indeed, Form N-1A, the general registration form for money market mutual funds and other open-end management investment companies, classifies disclosures regarding sales loads differently from disclosures regarding 12b-1/shareholder servicing fees.[74] Specifically, sales loads are classified as "shareholder fees (fees paid directly from investment)" while 12b-1/shareholder servicing fees are classified as "annual fund operating expenses (expenses that are deducted from Fund assets)." It is precisely these operating expenses that the NASD's advertising guidance imports into the definition of "no-load." Clearly, the federal statute, applicable Commission regulations and forms recently approved by the Commission more accurately reflect the Commission's view on this issue than does a staff letter written almost seven years ago.

---

exemption in principle, the exemption only applies to indenture trustees that effect transactions in no-load money market mutual funds. No-load would be defined under new Rule 3a4-3 the same as it is under the sweep exception.

[70] See Letter from Chairman James A. Leach to Arthur Levitt, Chairman of the Securities and Exchange Commission, dated January 2, 2001.

[71] See Letter from Chairman Phil Gramm to Arthur Levitt, Chairman of the Securities and Exchange Commission, dated February 6, 2001. ("At the time Congress enacted the Title II broker-dealer exemptions, Congress did not intend that rules, definitions, or interpretations would be changed in a way that would limit the current activities preserved by the exemptions.")

[72] Letter from Barry P. Barbash, Director of Investment Management to Paul Schott Stevens, General Counsel, Investment Company Institute (August 22, 1994).

[73] Section 2(a)(35), 15 U.S.C. 80a-2(a)(35); Rule 6c-10, 17 CFR 270.6c-10; and Form N-1A, 17 CFR 274.11A.

[74] See Item 3 and Instructions 2 and 3, and Item 8 to Form N-1A.

We note also that 16 years ago, when the Commission first recognized that an exception for bank sweep services was necessary, the term "no-load" was generally understood to mean sales charges only. Moreover, an exception for sweeping into no-load money market funds has been in every version of financial modernization legislation considered by the House and Senate Banking Committees since 1988.[75] At no time in the eleven years since the Proxmire Financial Modernization Act of 1988 was first considered and approved by the Senate has the legislative history given any indication that a change in the meaning of the term "no-load" was intended.

Furthermore, the Commission's interpretation ignores the reality of the situation. These accounts are marketed and sold as deposit accounts with sweep services being merely incidental to the account itself. Interest earned on the sweep is posted to the deposit account and disclosed to the customer on the monthly account statement.[76] To the consumer, the account looks and feels like a deposit account and should be treated as such under the push-out provisions.

Finally, we suggest that before any action is taken by the Commission that might encourage consumers to move their sweep accounts to broker-dealer firms, consideration should be given as to what impact, if any, such a movement would have on the availability of deposits to fund loans in local communities. Many banks offer sweep services that only sweep amounts in excess of a target amount, for example, $50,000. Amounts below the target amount are then made available with other deposit account balances to fund loans. It would be prudent for the Commission and bank regulators to consider this issue jointly before any regulatory action is taken that could cause significant disintermediation of bank deposits.

V. The Fund/Serv Exception contained in Rule 3a4-6 does not go far enough.

By letter of November 7, 2000, the ABA and ABASA requested guidance from Commission staff regarding bank purchases and redemptions of mutual fund shares.[77] Specifically, Paragraph 3(a)(4)(C) requires certain purchases and sales of U.S. publicly traded securities to be directed to a registered broker-dealer for execution (hereinafter "the broker-dealer execution requirement").[78] As we explained in our letter, banks generally do not purchase and redeem shares of mutual funds through registered broker-dealers but, rather, purchase or redeem these securities through automated systems that do not always provide for an interface

---

[75] See Proxmire Financial Modernization Act of 1988, S. 1886, 100th Cong., 2d Sess. (1988); H.R. 1505, 102nd Cong., 1st Sess. (1991); S. 543, 102nd Cong., 1st Sess. (1991); H.R. 1062, 104th Cong., 1st Sess. (1995); H.R. 2520, 104th Cong., 1st Sess. (1995); H.R. 10, 105th Cong., 1st Sess. (1997); H.R. 4870, 105th Cong., 2nd Sess. (1998); H.R. 10, 106th Cong. 1st Sess. (1999); S. 900, 106th Cong., 1st Sess. (1999).

[76] This is not to say that the appropriate disclosures concerning the lack of FDIC insurance or the risks associated with investing are not given to consumers. Bank regulatory guidance specifically requires these disclosures. Similarly, mutual fund fees are fully disclosed to the consumer through delivery of the mutual fund prospectus. See FIL 80-98, 1998 FDIC Interp. Ltr. LEXIS 74 (July 16, 1998).

[77] See Letter to Catherine McGuire, Associate Director, Division of Market Regulation, Securities and Exchange Commission, ABA and ABASA, dated November 7, 2000.

[78] The broker-dealer execution requirement applies to the trust and fiduciary exception, the stock purchase plan exception and the safekeeping and custody exceptions included in Title II. The ABA/ABASA request for interpretive guidance applied equally to all three exceptions from push-out.

between the bank and the fund distributor. Sometimes the interface may be with the mutual fund's investment advisor, the fund administrator or the transfer agent.

In that letter, we specifically asked that the staff interpret subparagraph (C) to permit banks to interact with a fund's transfer agent, administrator or investment advisor without the need for a broker-dealer to be interposed between the current parties to the transaction. We stated our belief that such relief was within the spirit, as well as the intent of subparagraph (C), especially subparagraph (C)(iii) which grants the Commission the flexibility to permit trades to be conducted in some other manner.

While our letter extensively discussed the Fund/SERV system, operated through NSCC/DTCC, our request for relief specifically contemplated transactions not involving the Fund/SERV system. Purchases of bank proprietary mutual funds by affiliated bank trust companies are not processed through the Fund/SERV system. These purchases are generally directed to the affiliated mutual fund's transfer agent. In addition, not all banks and mutual funds are NSCC members or have opted to use the Fund/SERV system. Industry experts do expect the trend toward using Fund/SERV to continue, however

New Rule 3a4-6 would only exempt banks from the broker-dealer execution requirement of Section 3(a)(4)(C) so long as the transactions in investment company securities are effected through the NSCC's Mutual Fund Services. While the relief granted by the Commission in new Rule 3a4-6 is very much welcome, it is only half of the proverbial loaf. Relief is needed for fund transactions that are not effected through NSCC and, consequently, we request the Commission to allow mutual fund purchases and redemptions to be directed to the fund's transfer agent. Mutual fund transfer agents are registered under the federal securities laws and federally supervised. In promulgating new Rule 3a4-6, the Commission specifically took comfort from the fact that NSCC was a clearing agency registered under the federal securities laws. The Commission should take equal comfort in the fact that transfer agents are subject to federal supervision and oversight.

VI. NASD Rule 3040 is inapplicable to bank/broker-dealer dual employee situations.

The narrative portion of the Commission's adopting release references NASD Rule 3040[79] and suggests that Rule 3040 applies in certain bank/broker-dealer dual employee situations. If this is so, Rule 3040 would, among other things, require a dual employee effecting a securities trade as a bank employee under one of the Title II exceptions to get approval from a broker-dealer supervisor before executing the transaction. In addition, significant burdens are imposed on the broker-dealer to monitor, to supervise and to keep records regarding the dual employee's securities activities legally effected under one of the Title II exceptions.

The Congress never intended for securities regulators to reach dual employees when functioning in their bank employee capacity. As employees of banks, any securities activities effected in compliance with the Title II exceptions is to be regulated by the banking regulators. For example, securities activities conducted under the trust and fiduciary exception are to be regulated by the bank regulators. Indeed, in order to qualify for the trust and fiduciary exception bank fiduciary departments must be adequately examined by bank regulators for compliance

---

[79] See n. 289 at 66 Fed. Reg. at 27792-93.

with fiduciary principles. No need exists for broker-dealers to supervise bank employees when executing securities transactions under the trust and fiduciary exception or, indeed, any other Title II exception.

The Conference Report affirms our position. Specifically, the Conference Report directed the NASD to revise one of its rules (Rule 1060) which was in conflict with Title II's networking exception. See Conference Report 106-434, 106th Congress 1st Session at 164 (1999) ("Revisions to Rule 1060 recently approved by . . . the NASD are in conflict with this provision. As a consequence, revisions to the rule should be made to exempt banks and their employees from the provisions' coverage.")

NASD Rule 1060 would have required bank employees involved in introducing bank customers to securities services offered by broker-dealer affiliates to submit to the NASD's jurisdiction. Yet the networking exemption specifically permitted bank employees to do exactly what the NASD sought to claim jurisdiction over. The Congress settled the issue by making clear that activities permissible under the networking exception are not properly subject to the jurisdiction of securities regulators.

This same reasoning holds true here. Activities properly conducted under the Title II exceptions are not subject to the jurisdiction of securities regulators. Securities regulators cannot claim jurisdiction over activities that the Congress specifically permitted to be performed in the bank.

Moreover, the Gramm-Leach-Bliley Act specifically embraced the concept of functional regulation. Allowing the Commission or the NASD to supervise legitimate bank activities flies in the fact of that concept. Accordingly, we urge the Commission to clarify that Rule 3040 does not require broker-dealer supervision of bank securities activities engaged in by dual employees.

CONCLUSION

In conclusion, the ABA and ABSA appreciate the opportunity to offer their views on the Commission's interim final rules. While we continue to oppose the rules on the grounds that they do not comport with Congressional intent and impose huge and unnecessary regulatory burdens on our members, we do appreciate the fact that the Commission and its staff have been most generous with their time in meeting to discuss these issues with industry representatives. We hope that these meetings combined with comments elicited during the comment process will result in significant changes being made to the rules. We strongly urge the Commission to provide certainty to the industry by indicating as soon as reasonably possible whether and for how long Commission rules implementing Title II may be delayed.

Should you wish to discuss matters raised in this letter, please do not hesitate to contact Sarah A. Miller at (202) 663-5325.

Sincerely,

Edward L. Yingling
Deputy Executive Vice-
President and Executive Director
American Bankers Association

Beth L. Climo
Executive Director
ABA Securities Association

cc: David Becker
Annette Nazareth
Robert L. D. Colby
Catherine McGuire
Lourdes Gonzales