BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM
FEDERAL DEPOSIT INSURANCE CORPORATION
OFFICE OF THE COMPTROLLER OF THE CURRENCY

June 29, 2001

Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 5th Street, NW
Washington, D.C. 20549-0609

Re: Interim Final Rules for Banks, Savings Associations, and Savings Banks Under Sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934 (the "Exchange Act"), Release File No. S7-12-01 ("Interim Final Rules")

Dear Mr. Katz:

The Federal Reserve Board, Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency ("Banking Agencies") appreciate this opportunity to provide comments on the Interim Final Rules issued by the Securities and Exchange Commission (the "Commission" or "SEC"). In brief, we have very serious concerns about the validity and content of a number of provisions of the Interim Final Rules, as well as the process the Commission employed to issue them.

The Interim Final Rules implement provisions of the Gramm-Leach-Bliley Act ("GLB Act") that eliminate the blanket exemptions for banks from the definitions of "broker" and "dealer" under the Exchange Act, and replace those exemptions with more specific activity-focused exemptions. Congress designed the new exemptions to permit banks to continue providing trust, fiduciary, custodial, and other traditional banking services to meet customers' financial needs.

The Interim Final Rules, however, are, in a number of critical respects, contrary to the express statutory language in the exemptions and congressional intent. The Interim Final Rules also create an extremely burdensome regime of overly complex, costly and unworkable requirements that effectively negate the statutory exemptions and the congressional intent underlying those exemptions. By regulating and restricting banking operations, the Rules adopt an approach that is fundamentally inconsistent with the principles of functional regulation that underlie the GLB Act.

As we discuss in more detail in the attached Appendix, the Interim Final Rules are premised on misunderstandings of how certain activities are conducted by banks. As a result, the Rules will significantly disrupt and may force discontinuation of major lines of business for banks and longstanding relationships with their customers. Because of the complexity and numerous non-statutory conditions imposed by the Rules, the Rules will also impose substantial additional costs on banks. As a result, customer costs may increase. These consequences of the Rules are wholly unwarranted given longstanding customer protections provided under federal and state banking and fiduciary laws, and congressional recognition that banks have provided these services "without any problem for years."[1]

The Interim Final Rules also were issued without the benefit of the normal notice and public comment process. This is a particular concern because our agencies advised Commission staff of the significant practical operational implications of potential approaches to implementing the revised exemptions. We specifically urged that understanding and resolution of those issues could be greatly aided by an open process of public comment on a proposal. Given the magnitude of the impact of the Rules on the traditional practices of banks and on bank customers, we believe that the process used by the Commission of publishing Interim Final Rules without first receiving the benefit of public comment is fundamentally unfair and inconsistent with sound administrative practice.

Moreover, use of Interim Final Rules with an immediate effective date, coupled with exemptions that function only to *temporarily* suspend the Rules' effectiveness, places banks in an untenable position. Although the Rules require substantial modification, banks must take steps now to comply with them by the effective date, since they have no way of knowing how or when the Rules may be changed. We believe it is wrong to require banks to establish procedures to comply with the Interim Final Rules before the Commission has reviewed public comments and addressed the significant concerns raised by the Banking Agencies and the banking industry.

Given the critical flaws in the Interim Final Rules and their impact, we strongly urge the Commission to take steps immediately to formally treat the Interim Final Rules as proposed rules and take the steps necessary to address the concerns outlined in this letter, the attached Appendix and public comments. In addition, because of the fundamental unfairness of requiring banks to conform to costly requirements that need to be revised substantially, we believe that the Commission should immediately further extend the effective date of the GLB Act's push-out provisions until after the proposed rules are issued as final rules. We also believe that the Commission should provide banks at least a one-year transition period after the revised rules become final to bring their operations into compliance with those new rules.

Our major concerns with the Interim Final Rules are summarized below, and are set forth in detail in the attached Appendix.

[1] S. Rep. No. 106-44 at 10 (1999).

I. Background

The GLB Act provides specific exemptions from the broker and dealer definitions that permit banks to continue providing trust and fiduciary, custody and safekeeping, asset-backed securities, and other specified traditional banking products and services. In enacting these exemptions, Congress recognized that banks have the expertise and customer relationships that make them uniquely qualified to provide these products and services. Congress also recognized that banks have provided these products and services effectively, under applicable regulatory requirements, for years. As noted in the Conference Report, the GLB Act provides specific exemptions for banking activities from broker-dealer requirements to "facilitate certain activities in which banks have traditionally engaged." Congress also expressed its expectation, "that the Commission will not disturb traditional bank trust activities."[2]

II. Trust and Fiduciary Activities

The Interim Final Rules are contrary to the GLB Act's exemption for trust and fiduciary activities because they impose unworkable requirements not found in the statute that effectively negate the availability of the exemption for many banks. This result also is directly contrary to congressional intent that traditional bank trust and fiduciary activities not be disturbed by the Commission's rules.[3] Trust and fiduciary products and services have long been offered to bank customers subject to comprehensive legal requirements that offer extensive customer protections. Bank examiners regularly examine these activities for compliance with trust and fiduciary principles. In light of the extensive regulation of bank trust and fiduciary activities, Congress adopted the exemption to permit banks to continue providing these traditional customer services.[4]

The Interim Final Rules also fail to recognize the fundamental reality of the trust business. State laws typically limit which corporations may serve as trustees. Banks and trust companies, but not broker-dealers, generally are authorized to act as trustees subject to a comprehensive regulatory scheme under state and Federal law. If the Interim Final Rules force trust activities out of banks, customers will have fragmented relationships with their chosen trustee and a third-party broker-dealer, and be burdened with additional costs that are unnecessary in light of the strong protections already afforded by the fiduciary requirements imposed on trustees.

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[2] *See* H.R. Conf. Rep. No. 106-434 at 163, 164 (1999).

[3] *Id. See also* S. Rep. No. 106-44 at 10 (1999).

[4] The Senate Report states "Banks have historically provided securities services largely through their trust departments, or as an accommodation to certain customers. Banks are uniquely qualified to provide these 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." S. Rep. No. 106-44 at 10 (1999).

A. Chiefly Compensated

Although Congress wanted to preserve traditional trust and fiduciary activities of banks, Congress did not want banks to circumvent the securities laws by operating a full-scale brokerage business through their trust departments. Congress addressed this concern through the exemption for trust and fiduciary activities by requiring a bank to be "chiefly compensated" for its trustee or fiduciary related transactions on the basis of non-brokerage related fees and by prohibiting the bank from publicly soliciting brokerage business. At the same time, Congress concluded that the trust and fiduciary laws and the oversight by Federal and state banking agencies provide sufficient consumer protection for banks that operate within the statutory standards. The Interim Final Rules, on the other hand, attempt to address the Commission's concern by unduly narrowing the limits on compensation a bank can receive from its trust and fiduciary accounts.

The language of the GLB Act and its legislative history suggest that the chiefly compensated limit should be applied on an aggregate basis to the bank's trust and fiduciary activities, and not on an account-by-account basis, to achieve its purpose.[5] The Interim Final Rules, however, require banks to conduct an account-by-account review, and establish for each individual trust or fiduciary account, that the bank is "chiefly compensated" by specified fees. This approach is inappropriate and, in many cases, unworkable as applied to banks' multi-faceted trust and fiduciary services and frequent multi-party trust and fiduciary relationships. Moreover, the Rules create a unique definition of compensation for purposes of the "chiefly compensated" computation that excludes legitimate, long-recognized forms of fiduciary compensation. These exclusions are nowhere found in the statute and will unnecessarily force banks to restructure existing customer relationships at great costs to both themselves and their trust and fiduciary customers.

B. Trustee Exemption

The GLB Act expressly provides that the exemption is available when banks effect transactions in a "trustee" capacity provided the bank complies with certain requirements. Despite the plain language of the GLB Act, the Interim Final Rules create ambiguity concerning the scope of this important term by suggesting that some parties treated as trustees under Federal and state law may be excluded from the definition of "trustees" for purposes of this exemption. This provision, too, is contrary to plain language and the clear intent of Congress to preserve traditional bank trust activities.

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[5] *See* H.R. Rep. No. 106-74, pt. 3, at 164 (1999) (A "bank must be chiefly compensated for its trust and fiduciary activities" on the basis of the fees specified by the Act.) (e*mphasis added*).

C. Investment Advice for a Fee

The Interim Final Rules also are contrary to the statutory language in the GLB Act that defines investment advice for a fee as a fiduciary activity. The plain language of the GLB Act establishes that banks providing investment advice for a fee fall within the trust and fiduciary exemption. These activities are explicitly defined as fiduciary under Federal banking regulations.[6] The Interim Final Rules here again devise a new, more constricted, definition not found in the statute. Under the Interim Final Rules, an investment advisor is engaged in fiduciary activities only if it provides continuous and regular investment advice to the customer's account and meets other additional requirements. This result also is contrary the literal words of the GLB Act and to congressional intent to preserve this longstanding fiduciary activity.

III. Custody and Safekeeping Activities

The Interim Final Rules also are contrary to the statute and legislative history of the GLB Act's exemption for custody and safekeeping activities because they exclude order-taking activities that are part of customary banking activities. Bank custodians have a long-standing history of accommodating customers by accepting and transferring orders for securities to a registered broker-dealer. The GLB Act includes an exception for safekeeping and custody services to preserve the traditional role of banks in providing customary custodial services for their customers, which customarily included order-taking. In enacting this exemption, Congress expressed clear intent that traditional custodial, safekeeping and clearing activities, including custodial IRA relationships, be allowed to remain within the bank.[7] Contrary to this statutory scheme and congressional intent, the Interim Final Rules do not include customary custodial order-taking services within the exemption.

The Interim Final Rules create two special exemptions that would not be needed if the Commission recognized that the Act permits banks to continue offering order-taking services to customers. One exemption permits bank custodians to continue providing customary order taking services if they do not charge any fees for the service. Neither the statute nor its legislative history provides any support for prohibiting banks from charging fees for their customary custody and safekeeping activities. This restriction will cause banks either to stop offering this service, or to move custodial activities outside the bank, contrary to the statute and congressional intent.[8]

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[6] 12 C.F.R. § 9.2 (e).

[7] The Senate Report states "the Committee believes that bank custodial, safekeeping, and clearing activities with respect to IRAs do not need to be pushed-out into a Commission registered broker-dealer." S. Rep. No. 106-44, at 10 (1999).

[8] The other exemption applies only to small banks and includes numerous burdensome restrictions.

IV. Networking

The Interim Final Rules are contrary to the statutory language of the GLB Act's exemption for networking because they create new limits on referral fees that are not found in the statute. The GLB Act specifically permits a bank employee to receive a nominal one-time cash fee of a fixed dollar amount for referring customers to the broker-dealer. The Interim Final Rules impose completely new requirements on the amount that may be paid for these referrals and the manner in which they may be paid that will effectively negate for many banks the availability of the specific statutory provision allowing for referral fees.

V. Cure Mechanism

The Interim Final Rules fail to address their effect on banks that discover some securities transactions do not comply with an exemption due to inadvertent errors or unforeseen circumstances. Banks that take reasonable steps and attempt in good faith to comply with the Rules may suffer unduly harsh and inappropriate consequences from minor infractions. For example, because some calculations required under the Rules are completed at year-end, a bank may not learn until then that a minor inadvertent error caused it to be out of compliance during the entire past year. Or, a single transaction that fails to meet a technical requirement under the Rules may cause a bank to become an unregistered broker-dealer, subject to considerable liabilities under the Exchange Act. The Banking Agencies believe it is critically important for the Commission to clarify that a bank will not be considered a broker-dealer if it has policies and procedures reasonably designed to comply with exemptions and attempts in good faith to conform to the exceptions. The Commission should offer the bank a reasonable period of time to bring its operations into compliance in these circumstances.

VI. Recordkeeping Requirements

Section 204 of the GLB Act explicitly directed the Banking Agencies to establish recordkeeping requirements for banks relying on the broker-dealer exemptions. Even so, the Commission solicits comments on whether it should issue these recordkeeping requirements. This proposal is contrary to the plain language of § 204, which specifically grants the Banking Agencies authority to establish these recordkeeping requirements.

VII. Other Areas of Concern

The Interim Final Rules also raise concerns in several other significant areas that are addressed in more detail in the attached Appendix. These areas include the exemptions for affiliate transactions, sweep accounts, asset-backed securities activities, and supervision of dual employees. Further, the failure of the Interim Final Rules to comply with the language and intent of the GLB Act raises serious questions about how the Commission may later interpret exemptions that are not addressed by the Rules. We believe it is imperative that the Interim Final Rules comport with the language and intent

of the GLB Act provisions they address, so that banks know they may rely on the language and intent of other GLB Act provisions in conducting their activities.

VIII. Conclusion

In summary, we believe the Interim Final Rules are contrary to the plain language of the GLB Act and its legislative history in various critical respects. By imposing unnecessarily burdensome, costly and unworkable requirements, the Interim Final Rules effectively eliminate exemptions established by statute, disrupt existing customer relationships and force traditional banking activities out of banks, a result that Congress specifically sought to avoid. Given the magnitude of the issues presented and the extent of the impact of the Rules on major activities in the banking industry, we urge the Commission to take the steps described at the outset of this letter in order to faithfully implement the statute in accordance with its terms and legislative intent. Our agencies stand ready to provide the Commission with information concerning the traditional and customary activities of banks that Congress sought to protect and to work with the Commission and its staff to address the concerns expressed in this letter in order to develop rules that are consistent with both the spirit and language of the GLB Act.

Sincerely,

/s/
Alan Greenspan, Chairman
Board of Governors of the
Federal Reserve System

/s/
Donna Tanoue, Chairman
Federal Deposit Insurance Corporation

/s/
John D. Hawke, Jr.
Comptroller of the Currency