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Northern Trust

March 26, 2007

Jennifer J. Johnson, Secretary
Board of Governors of the
Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Nancy Morris, Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 205649-1090

RE: FRB Docket No. R-1274
SEC File Number S7-22-06

Dear Ms. Johnson and Ms. Morris:

Northern Trust Corporation ("Northern Trust") appreciates this opportunity to comment on proposed Regulation R, which was issued jointly by the Board of Governors of the Federal Reserve System ("Board") and the Securities and Exchange Commission ("Commission") (collectively, the "Agencies") on December 18, 2006, to implement certain of the exceptions for banks from the definition of the term "broker" under Section 3(a)(4) of the Securities Exchange Act of 1934.

Northern Trust is a leading provider of investment management, asset and fund administration, fiduciary and banking solutions for corporations, institutions and affluent individuals worldwide. A financial holding company based in Chicago, Northern Trust has a growing network of 84 offices in 18 U.S. states and international offices in North America, Europe, and the Asia-Pacific region. As of December 31, 2006, Northern Trust had assets under custody of $3.5 trillion, assets under management of $697 billion, and banking assets of $61 billion.

In July of 2001 Northern Trust filed a comment letter with the Commission in connection with our review of a predecessor rule proposal under GLBA known as the "Interim Final Rules". In that letter we asked the Commission to clarify application of the "Execution by a Broker or Dealer" requirement under Exchange Act Section 3(a)(4)(C) as it relates to certain types of "company stock" transactions effected for employee benefit plan customers. Because our comments in this regard were not addressed by the Commission or by Regulation R, we are respectfully resubmitting them to the Agencies now.

Banks traditionally have effected several types of "company stock" transactions as a service to their employee benefit plan customers without a need for brokerage execution. For instance, it is a common practice for the sponsors of qualified defined contribution (e.g., 401(k)) and defined benefit retirement plans to make in-kind contributions of company stock to their plans and to engage in direct purchases and sales of company stock with their plans. Such transactions are expressly permitted by section 408(e) of the Employee Retirement Income Security Act of 1974 ("ERISA"), provided that the acquisition or sale by the plan is for adequate consideration and "no commission is charged with respect thereto". Plans do not use brokers in such transactions because of the "no commission" requirement of 408(e). To require brokerage execution for such transactions would effectively preclude plans from engaging in them because, without 408(e) protection, such transaction could be deemed to violate ERISA's "party-in-interest" rules and plan sponsors engaging in them could incur excise tax liability under Section 4975 of the Internal Revenue Code.

It is also common for defined contribution retirement plans that permit investments in company stock to allow for the in-kind distribution of such stock to plan participants and beneficiaries. Under U.S. tax law distributees generally may defer recognition of gain on the "net unrealized appreciation" attributable to company stock received in a lump sum distribution from eligible plans. Such transactions are typically effected directly through the plan sponsor's transfer agent without the use of a broker.

In addition, where sponsors of benefit plans with company stock holdings are involved in corporate spin-offs, their plans often receive distributions of stock in the spun off company. In many cases, such plans either desire or are legally required to dispose of such "spin stock" and reinvest the proceeds in additional shares of their own company's stock. For example, employee stock ownership plans (ESOPs) are required to invest "primarily" in securities of their plan sponsor as a condition of tax qualification.

Benefit plans of the spun off company are often natural buyers of the "spin stock" and natural sellers of the company stock that benefit plans of the original company may need to buy. It is a common practice for banks, acting as trustees or custodians for such benefit plans, to effect transactions directly between the plans in such situations without the use of a broker. Where the same bank acts as trustee or custodian for the benefit plans of both companies, such transactions could presumably be effected via an internal cross trade consistent with Exchange Act Section 3(a)(4)(C)(ii), but in many cases the companies utilize trustees/custodians that are independent of one another.

In each of the above situations, effecting company stock transactions without the use of a broker benefits the plans and their participants by eliminating trading costs that otherwise would be incurred. In each case the plan's trustee or custodian receives or transfers stock and/or cash to facilitate the transaction and coordinates with the company's transfer agent to effect re-registration of the affected securities. If the bank trustee/custodian were itself the company's transfer agent, it could presumably rely upon the exception from the definition of the term "broker" under Exchange Act Section 3(a)(4)(B)(iv), but in most cases the transfer agent will be an independent party.

In its commentary to the Interim Final Rules relating to the "Custody and Safekeeping Exception," the Commission said:

> Exchange Act Section 3(a)(4)(C) does not require all orders to purchase and sell a security to be sent to a registered broker-dealer. To read the section otherwise would mean that a bank would always be required to purchase or sell the underlying securities through a registered broker-dealer in connection with, for example, an investor's exercise of rights or warrants. This would preclude a bank from filling an investor's exercise of rights or warrants by delivery of shares from the issuer—a commonly used method. However, if a bank does purchase or sell the underlying securities *in the open market*, Exchange Act Section 3(a)(4)(C) requires banks either to execute the transactions through a registered broker-dealer or internally to cross the trade. [Emphasis added.]

Similarly, the Agencies made the following statement in their discussion of the proposed custody exemption under Regulation R:

> A bank would have no need to rely on the custody exemption to the extent the bank conducts other custodial activities permitted by Section 3(a)(4)(B)(viii) (e.g., exercising warrants or other rights with respect to securities. . ."

All of the above-described "company stock" transactions are similar to the exercise of rights or warrants in that they do not involve open-market trades and raise no apparent investor protection concerns. It is our view that such transactions should not require the execution services of a broker-dealer merely because a bank effects them. We therefore urge the Agencies to clarify that all of the foregoing types of transactions are excepted from the broker-dealer requirement under Exchange Act Section 3(a)(4)(C).

Sincerely,

Dale K. Nichols
Assistant General Counsel