Bank of Montreal Harris Bank

March 26, 2007

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

Ms. Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, N.E.,
Washington, D.C., 20549-1090

Re: Definitions of Terms and Exemptions Relating to the "Broker" Exceptions for Banks; Release No. 34-54946 (SEC File No. S7-22-06); (Fed Docket No. R-1274) ("Proposed Regulation R")[1]

Dear Ms. Johnson and Ms. Morris:

On behalf of Harris N.A. and The Harris Bank N.A. (collectively, "Harris"), we appreciate the opportunity to comment on Proposed Regulation R issued jointly by the Board of Governors of the Federal Reserve System and the Securities and Exchange Commission ("Commission") (collectively, the "Agencies") to implement certain provisions of the Gramm-Leach-Bliley Act of 1999 ("GLB Act").

Harris is part of the Bank of Montreal and its group of companies ("BMO Group"). In the United States, BMO Group comprises several bank and non-bank entities, including brokerage firms, with a total of approximately $80 billion in assets. BMO Group offers a wide range of financial services, including trust, private banking, and investment management services.

1. Introduction and General Comments

[1] 71 Fed. Reg. 77522 (December 26, 2006).

We have had the opportunity to participate in informal dialogues about Proposed Regulation R, through the American Bankers Association's programs, with representatives of the Agencies. Harris appreciates the Agencies' willingness to participate in these dialogues.

Harris fully endorses the positions of the American Bankers Association and ABA Securities Association in their letter to the Agencies dated March 26, 2007 ("ABA/ABASA Letter"). Our more specific comments follow.

Of highest importance to us are challenges presented by the "Networking", "Trust and Fiduciary", and "Custody and Safekeeping" exceptions. We also are concerned about the lack of clarity surrounding the application of NASD Rule 3040.[2]

<u>2. Networking Exception</u>

The GLB Act permits banks to enter into arrangements with broker-dealers to offer brokerage services to bank customers, provided that the arrangement meets certain requirements ("Networking Exception").[3] Among those requirements is that unregistered bank employees do not receive "incentive compensation" for any brokerage transactions or that such compensation be no more than a "nominal one-time cash fee of a fixed dollar amount."[4] Proposed Regulation R provides a qualified exemption to these requirements when the bank customer is an institution or a high net worth individual.

<u>(a) Bonus Programs</u>

Proposed Regulation R defines "incentive compensation."[5] Certain bonus programs are excluded from this definition.[6] Under Proposed Regulation R bank employees can be paid based

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[2] That Rule requires registered representatives involved in securities transactions outside of their member firm to comply with certain notice, approval and supervision requirements. The member firm also may be required to pre-approve and monitor transactions as if they were conducted on behalf of the member firm.

[3] 15 U.S.C. § 78c(a)(4)(B)(i).

[4] 15 U.S.C. § 78c(a)(4)(B)(i)(VI).

[5] Proposed Rule 700(b), 71 Fed. Reg at 77544.

on the overall "*profitability*" of the bank and its affiliates (including, under certain conditions, an affiliated broker-dealer) or operating units.[7] A bank employee also can be compensated on a discretionary basis, taking into account multiple factors, including significant factors not related to securities transactions at the broker, so long as the number of referrals made by the employee or any other person is not a factor that may be included in determining the employee's compensation.[8]

Harris has a number of different bonus programs to reward employees based on their differing roles and responsibilities. Typically, our bonus programs use a formula containing a discretionary component and are based on a combination of performance objectives and stated targets with the goal of increasing and solidifying customer relationships throughout Harris and its affiliates.

For example, an employee's bonus award at Harris may be based on the following variables: year-over-year team *revenue* growth targets for the bank and its affiliates, new sales *revenue* targets at the bank and its affiliates, number of new customers to the bank and its affiliates, governance objectives (discretionary assessment of the employee's ability to successfully perform direct duties), and management assessment (discretionary assessment of the employee's contribution, considering such things as customer retention and broadening the customer relationship). The financial performance of our organization at various levels (e.g., BMO Group, Harris and the employee's particular business unit) may also be part of the factors considered. That is, our incentive plans do not relate to *profit* (revenue less expenses) as much as *revenue* targets.

We believe that the definition of "incentive compensation" included in Proposed Regulation R permits our employees to be compensated on a customer relationship basis which would include Harris' foregoing objectives and targets. We understand that the number of employee, team or branch referrals to the broker would not be a permissible factor under Proposed Regulation R. However, the growth of new revenue generated by brokerage services

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[6] While we appreciate the Agencies' recognition that traditional bank bonus programs should not fall within the definition of "incentive compensation," we still maintain that the GLB Act was not intended to regulate bank bonus programs at all.

[7] Proposed Rule 700(b)(2), 71 Fed. Reg at 77544.

[8] Proposed Rule 700(b)(1), 71 Fed. Reg at 77544.

initiated by bank employee referrals to our affiliate broker would appear to be a permissible factor (and even a permissible significant factor) since other significant factors are present.[9]

As indicated above, many of our bonus awards contain factors based on revenue growth rather than profitability. Therefore, we respectfully request that the specific language in Proposed Rule 700(b)(2) be changed to accommodate the notion of "revenue," "financial performance," or other such terminology making clear that profit, as technically defined, is not necessary.

(b) Referral Fees

The GLB Act permits a bank's unregistered employees to receive compensation for referrals to a broker if the compensation is a "nominal one-time cash fee of a fixed dollar amount."[10] Proposed Regulation R defines this language to mean an amount not to exceed (i) twice the employee's hourly pay, (ii) a fraction of, or a multiple of, the base annual salary of the employee's job family, or (iii) twenty-five dollars ($25), adjusted for inflation.[11]

The ability to choose alternative referral fee structures is useful. However, we believe that those of our employees that are primarily paid contingent compensation will be disadvantaged. Certain Harris employees, such as mortgage brokers and sales personnel, are compensated primarily on a contingent basis. These employees could receive a lower referral fee because their base salaries are relatively low.

Therefore, we respectfully request the Agencies to consider expanding the definition of "nominal one-time cash fee of a fixed dollar amount" to include the employee's *total* annual compensation, excluding any portion based on securities referrals.

(c) High Net Worth and Institutional Customers

[9] *See* 71 Fed. Reg at 77525, footnotes 34 ("significant" factors play a non-trivial role in determining an employee's compensation under the plan) and 35 ("[t]he requirement that an employee's compensation not be based on 'a referral' made by the employee or another person also means that the employee's compensation under the bonus or similar plan may not vary based on the number of securities referrals made by the employee or another person to a broker or dealer").

[10] 15 USC 78c(a)(4)(B)(i)(VI).

[11] Proposed Rule 700(c), 71 Fed. Reg at 77544.

Proposed Regulation R permits banks that meet all other conditions of the Networking Exception to pay higher referral fees to those bank employees who refer high net worth or institutional customers to a broker.[12] Harris agrees with the comments made in the ABA/ABASA Letter with regard to this exemption and incorporates them here by reference.

We believe an exemption for such customers is appropriate given their financial sophistication. However, in our view the provisions in Proposed Rule 701 are much too complicated and restrictive to be useful, particularly for small and medium-size banks. The customer qualification hurdles are too high and inconsistent with other "net worth" rules.

For example, under current regulation, individuals with a net worth of $1 million may invest in Regulation D securities.[13] The Commission is considering raising this amount to $2.5 million for individual investors in certain private investment vehicles.[14] Under Proposed Regulation R, individual bank customers would be required to meet a *$5 million* threshold test (excluding the primary residence and other associated liabilities) to permit a higher-than-nominal fee for referral of that customer to a broker. But there is an inherent risk-level difference between a wealthy individual merely opening a brokerage account (involving lower levels of risk) and that same individual purchasing shares of an unregistered hedge or private equity fund (involving a higher level of risk) and, therefore, grounds for a *lower* net worth hurdle for the former.

We encourage the Agencies to consider revising this exemption to substantially simplify its application and make it more consistent with the level of risk that the customer is assuming. Moreover, we also believe that this exemption should be available to all bank employees regardless of their assigned duties.

3. Trust and Fiduciary Activities

(a) 70% Chiefly Compensated Test Across Multiple Bank Charters

[12] Proposed Rule 701, 71 Fed. Reg at 77545.

[13] *See* SEC Rule 501.

[14] *See* SEC Release No. 33-8766, 72 Fed. Reg. 400 (January 4, 2007).

The GLB Act provides a statutory exception for traditional trust and fiduciary activities of banks ("Trust and Fiduciary Exception").[15] The Trust and Fiduciary Exception authorizes a bank to effect securities transactions in a trustee or fiduciary capacity in its trust department or other department that is regularly examined by bank examiners, so long as the bank is "chiefly compensated," consistent with fiduciary principles, on the basis 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.[16]

One method of monitoring compliance with the "chiefly compensated" condition under Proposed Regulation R is to show that that the aggregate "relationship compensation" attributable to a bank's trust and fiduciary business as a whole is greater than 70% of the bank's total compensation attributable to the trust and fiduciary business (calculated on a rolling average for the two immediate preceding years) (the "70% Test").[17]

Currently Harris administers over 10,000 trust, estate and managed agency accounts nationwide through two national banking charters.[18] Because our trust and fiduciary businesses are operated across multiple bank charters, it would be useful to Harris if the 70% Test could be calculated across multiple banks within the same bank holding company.

Regardless of the separate legal entities, the trust activities that take place within the separate banks are internally managed and operated as one line of business. Calculating the 70% Test across our bank charters would align the calculation with how the business is actually managed and operated and prevent arbitrary decisions regarding the placement of accounts — decisions that could be based on extraneous factors unrelated to the needs of the client, namely, compliance with the 70% Test.

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[15] 15 U.S.C. § 78c(a)(4)(B)(ii).

[16] Id.

[17] Proposed Rule 722, 71 Fed. Reg at 77547.

[18] We have trust offices in Illinois and Indiana through Harris N.A., and in Arizona, Washington, Florida and Nevada through The Harris Bank N.A., both national banks with trust powers. Both Harris N.A. and The Harris Bank N.A. are owned by the same bank holding company. We also recently acquired First National Bank & Trust which is also owned by the same bank holding company.

Therefore, Harris respectfully requests that the Agencies permit the "chiefly compensated" calculations of the 70% Test to be performed across multiple banks within the same bank holding company.

(b) Clarification Regarding Source of Fees and Compliance with 70% Test

"Relationship compensation" under the GLB Act includes annual fees, asset under management fees, administration fees, flat or capped per order processing fees equal to the cost incurred by the bank in connection with executing securities transactions for trust and fiduciary accounts, any combination of the foregoing fees.[19] Proposed Regulation R also includes as "relationship compensation" 12b-1 fees, shareholder servicing fees, and fees paid for personal services, tax preparation, and real estate settlement services.[20]

The relationship compensation that Harris receives includes but is not limited to:[21]

- investment management fees;[22]
- fiduciary administration fees;[23]
- tax planning and tax preparation fees;[24]
- disbursement fees;[25]

[19] 15 U.S.C. § 78c(a)(4)(B)(ii).

[20] *See* Proposed Rule 721(a)(4), 71 Fed. Reg at 77546.

[21] It is our understanding that soft-dollar compensation is not includable in either relationship compensation or total compensation. It also is our understanding that payments received by the trust department from other areas of the bank or from affiliates based on an inter-company arrangement are not considered a part of relationship or total compensation.

[22] These fees generally are charged as a percentage of assets under management. However, for some small accounts, this fee is a flat fee. The flat fee varies depending on the size of the account.

[23] These fees are primarily charged as a percentage of assets under management and may vary depending on whether co-fiduciaries are acting with Harris and whether the trust account is revocable or irrevocable. Many of our accounts are charged based on older fee schedules implemented prior to 2003. Fiduciary administration fees for these accounts are typically based on a flat rate.

[24] Tax planning fees generally are charged on a retainer fee basis. Fees for tax preparation generally are charged as a flat fee that varies depending on whether the trust account is revocable, irrevocable, or for a charitable trust or foundation. In some cases tax planning and preparation fees are charged on a time and materials basis.

- special asset fees;[26]
- estate administration and death-related duty fees;[27]
- settlement fees;
- financial planning fees;
- fees for extraordinary administrative services;[28]
- account termination fees;[29] and
- 12b-1 and shareholder servicing fees.

All such fees are incurred in the course of administering fiduciary relationships and providing trust and fiduciary services to our customers.

Proposed Rule 721(a)(4)(iii) provides that fees based on assets under management may include, without limitation, 12b-1 and shareholder servicing fees paid by an investment

[25] These are flat fees charged per disbursement to a beneficiary when disbursements exceed four per month. These are disbursements requested by beneficiaries of the trust for living expenses, medical expenses, etc.

[26] These fees generally are charged as a percentage of the value of the special asset and vary depending on whether the bank has full or shared authority or is directed. Some assets may be charged on a flat fee basis. Special asset fees are charged for administering assets such as oil, gas and mineral interests, timber, closely-held business interests, royalty interests, and residential or investment real estate.

[27] These fees are charged as a percentage of estate assets. These services may include date of death and alternate date valuation, identification of assets at death, collection of assets at death, payment of debts, claims, medical and funeral expenses, preparation of final income tax return, payment of specific bequests, determination of liquidity needs for taxes, debts and expenses, collection of life insurance proceeds, IRA and retirement plan pay-out decisions, asset allocation and funding, and preparation of IRS Form 706 estate tax return.

[28] These fees are charged on an hourly basis depending on the level of bank employee requested to perform the service. These fees are charged for such services as identification, collection and re-registration of assets for grantors or revocable living trusts who become unable to manage their affairs, issues relative to administering a trust whose governing law is other than a state in which Harris has a trust office, statement research and retrieval, transferring title to illiquid or non-marketable assets, preparation of special reports (such as performance analysis and bond accretion), monitoring involvement in court proceedings, responding to subpoenas and preparation and participation in depositions and court hearings.

[29] These are processing fees that are charged per issue and per recipient to cover costs incurred in re-registering and distributing trust assets upon termination.

company.[30] It is our understanding that this language would not prevent such fees being paid by *service providers* to the mutual fund. The 12b-1 fees and shareholder servicing fees that Harris currently receives may be paid by the mutual fund's advisor, administrator, distributor, or transfer agent. Therefore, we respectfully request that the Agencies confirm this understanding.

Settlement fees are earned by our corporate trust and institutional trust areas. These fees are a flat dollar amount, charged per transaction, for settlement of purchases and sales in the account. The transactions are typically placed with the broker by the client's investment adviser, and Harris' responsibilities relate only to settlement of the trade. We believe these fees are properly characterized as administrative fees and are part of relationship compensation. We respectfully request that the Agencies confirm this point.

Harris believes that it would meet the "chiefly compensated" condition under the 70% Test of the Trust and Fiduciary Exception. We also anticipate being able to show our compliance by aggregating the general fee information that our current technology systems capture. However, our current systems do not capture detailed "relationship compensation" information. Any detailed breakdown of our total compensation from our trust and fiduciary businesses into detailed relationship compensation components will require a sweeping change to our systems. Therefore, and before significant system investment, Harris respectfully requests clarification from the Agencies as to the actual method of showing compliance with the 70% Test.

Proposed Regulation R provides that the calculation of the "chiefly compensated" exception under the 70% Test for any year requires averaging the bank's trust and fiduciary compensation for the preceding year and the year before that.[31] We are assuming that the calculation under the 70% Test need only be done once during a year but respectfully request clarification on this point.

In addition, compliance with Proposed Regulation R is not required until the first fiscal year beginning after June 30, 2008.[32] Since Harris' fiscal year coincides with the calendar year, it is our understanding that our compliance will not be required until January 1, 2009. It is also

[30] Proposed Rule 721(a)(4), 71 Fed. Reg at 77546.

[31] Proposed Rule 722, 71 Fed. Reg at 77547.

[32] Proposed Rule 781, 71 Fed. Reg at 77550.

our understanding that, once compliance is required, Harris should begin collecting the necessary information to perform the 70% Test, but that the first calculation under the 70% Test involving the preceding two years would not be done until 2011. We respectfully request that the Agencies confirm our understanding.

4. Custody and Safekeeping Exception

The GLB Act provides a statutory exception for certain safekeeping and custodial services of banks.[33] Specifically, the GLB Act permits banks continue to perform the following activities without registering as a broker: (1) provide safekeeping or custody services with respect to securities, including exercising warrants and other rights on behalf of customers; (2) facilitating the transfer of funds or securities, as a custodian or clearing agent, in connection with the clearance or settlement of customer securities transactions; (3) effect securities lending or borrowing transactions on behalf of customers in connection with safekeeping or custodial services or investing cash collateral pledged in connection with such transactions; (4) holding pledged securities or securities subject to a purchase or resale agreement involving a customer; and (5) serving 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 ("Custody and Safekeeping Exception").[34]

Accepting securities orders from customers has been a customary activity for banks, including Harris, that provide safekeeping and custodial services. The GLB Act itself permits banks under the Custody and Safekeeping Exception in the statute to continue their order-taking activities.

Proposed Regulation R permits banks to continue to accept securities orders for employee benefit plans and individual retirement accounts under certain conditions.[35] It also permits banks to continue to accept securities orders for other custodial accounts but *only* as an "accommodation" to the customer.[36] Even if the federal banking agencies issue guidance on this exemption as well as on the types of policies and procedures that banks must have in place, we question even the need for this exemption given the permissive language in the GLB Act itself.

[33] 15 U.S.C. § 78c(a)(4)(B)(vii).

[34] Id.

[35] Proposed Rule 760, 71 Fed. Reg at 77548.

[36] Id.

Moreover, Proposed Regulation R prohibits banks from providing to custodial customers investment advice or research, making recommendations concerning securities, or otherwise soliciting securities transactions from the account.[37]

Harris administers its customer accounts on a relationship basis. That is, one customer may have several trust accounts, an investment management account, and several custody accounts. All of these accounts may be administered by the same Harris employee or group of employees either at the request of the customer or for purposes of maintaining the customer relationship. In such case, a customer would receive investment advice or research regarding securities held in the trust and investment management accounts. However, Harris has *no* control over how the customer uses this advice or research with regard to the customer's *custody* accounts.

Therefore, we respectfully request that the Agencies modify Proposed Rule 760(b)(6) to indicate that nothing in the Rule shall prevent a bank from providing investment advice with regard to its trust and fiduciary customers whether that customer also is a custody customer .

Our custody customers receive a menu of mutual funds for purposes of choosing a sweep product. It is our understanding that this would not be deemed to be providing investment advice to these custody customers, but we would also like clarification on this point.

In addition, our custody customers may receive general, non-account specific investment information through bank newsletters or websites in order that we might cross-selling our advisory services to the customer. Over time, custody clients often extend their relationships with Harris to include, among other services, investment advice or fiduciary accounts. Harris respectfully asks the Agencies to modify Proposed Rule 760(b)(6) to permit such activities .

5. Interaction of GLB Act Exceptions

It would be helpful for the Agencies to confirm that the GLB Act exceptions are not mutually exclusive and that one or more may apply to exempt a particular bank activity. We incorporate here the comments made in the ABA/ABASA Letter in this regard.

6. Applicability of NASD Rule 3040

[37] Id.

The applicability of NASD Rule 3040 to dual-employee arrangements in which bank employees also are employees of a broker-dealer has not been resolved. Harris may rely on dual-employee relationships to comply with the exceptions under the GLB Act. Application of Rule 3040 to our bank employees who also are employees of our affiliated broker-dealer would require securities transactions made by such a dual employee in his or her capacity as bank employee to be (1) approved by the broker-dealer and (2) recorded on the broker-dealer's books and records.[38] Accordingly, each separate transaction must be approved and monitored by the broker-dealer, and the funds for the transaction must be transferred to the books and records of the broker-dealer. As a result of this regulatory burden, Harris may have no choice but to "push-out" all securities transactions to the broker-dealer. This would effectively deny Harris the benefits of the exceptions provided by the GLB Act, and would most definitely be contrary to Congressional intent.

Harris encourages the Agencies to work with the NASD to provide clarity in this area by confirming that NASD Rule 3040 does not apply to dual employees operating in their capacities as bank employees. It would be most useful if this issue could be resolved well in advance of the compliance dates for Proposed Regulation R.

Conclusion

Harris appreciates this opportunity to submit its views on Proposed Regulation R. We hope these comments are useful.

Sincerely,

/s/

Paul V. Reagan
Executive Vice President and U.S. General Counsel

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[38] *See* NASD Rule 3040.