PACE INVESTOR RIGHTS PROJECT
Pace University School of Law
78 NORTH BROADWAY
WHITE PLAINS, NY 10603
WWW.LAW.PACE.EDU/PIRP

JILL I. GROSS, DIRECTOR
PHONE: 914-422-4333
FAX: 914-422-4391
JGROSS@LAW.PACE.EDU

March 26, 2007

Ms. Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549

Re: File Number S7-22-06

Dear Ms. Morris:

We are writing in response to the Securities and Exchange Commission's solicitation of comments on proposed 12 CFR Part 218 and proposed Regulation R, 17 CFR Part 247.[1] We are commenting on behalf of the Pace Investor Rights Project (PIRP) at Pace University School of Law, which is committed to advocacy, research, and education in the area of investor rights. PIRP operates in conjunction with Pace University School of Law's Securities Arbitration Clinic (SAC), which represents small investors in arbitral disputes with their broker-dealers.

PIRP previously commented on Regulation B,[2] a proposal to broaden the number of exemptions available to banks, savings banks, and savings associations that effect transactions in securities.[3] PIRP's concerns stemmed from the impact the third-party brokerage exception in Exchange Act Section 3(a)(4)(B)(i)[4] may have on small investors and unsophisticated bank customers.[5] PIRP proposed various options including: amending the proposed definition of "nominal one-time cash fee of a fixed dollar amount" to reflect the lesser of the employee's salary or a $25 ceiling on the value of the referral fee; and creating guidelines to help banks police themselves and to ensure that necessary oversight is provided.[6] The SEC has now withdrawn Regulation B, and instead substituted proposed alternative definitions.

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[1] 71 Fed. Reg. 77522, 77522 (proposed Dec. 26, 2006) (to be codified at 17 C.F.R. pts. 240 and 247).
[2] Regulation B, 69 Fed. Reg. 39682.
[3] *See* Letter dated September 1, 2004 from Pace Investor Rights Project to Jonathan Katz, *available at* http://www.sec.gov/rules/proposed/s72604/bblack0900104.pdf (hereinafter PIRP comment).
[4] 71 Fed. Reg. 77522, 77533, citing 15 U.S.C. 78(c)(a)(4)(B)(i).
[5] *See* PIRP comment.
[6] *See id*.

The new proposal does not address the concerns we previously expressed. In particular, we remain concerned with the impact the "Nominal One-Time Cash Fee of a Fixed Dollar Amount" ("Nominal Fee") exception in Exchange Act Section 3(a)(4)(B)(i)(VI)[7] may have on individual investors of limited means. The proposed definition offers three alternatives for "nominal" referral fees. However, all three alternatives still provide a substantial incentive for retail bank employees to engage in behavior that is beyond the scope of the "nominal" fee originally contemplated by Congress, and at the expense of investor protection. By allowing retail banks to institute this referral fee structure, the Nominal Fee definition can lead unsophisticated bank customers to blindly invest substantial amounts of money in unsuitable investments.

Definition of Nominal

As we wrote previously, we support the Commission's prior view "that the term 'nominal' as used in the GLBA should be defined as that term is commonly understood"[8] and agree that "[i]n the context of compensation, and in common legal usage, a 'nominal' fee is a small one of no concern to the payor and little value to the payee."[9] Additionally, the current view defines "nominal" "in relation to the overall compensation of referring fees."[10] However, we do not believe that the Commission's proposed definitions are consistent with this understanding of the term "nominal."

Under proposed Regulation R, in order to be nominal, the referral fee must meet any one of these three alternative definitions:

> (1) "[A] referral fee would be considered nominal if it did not exceed either twice the average of the minimum and maximum hourly wage established by the bank for the current or prior year for the job family that includes the relevant employee, *or* 1/1000th of the average of the minimum and maximum annual base salary established by the bank for the current or prior year for the job family that includes the relevant employee";[11]
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> (2) "[A] referral fee would be considered "nominal" if it did not exceed twice the employee's actual base hourly wage";[12]
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> (3) "[A] referral fee would be considered nominal for the purposes of the networking exception if the payment did not exceed twenty-five dollars [$25]."[13]

Furthermore, the proposed "statutory exception does permit a retail bank employee to receive a 'nominal one-time cash fee of a fixed dollar amount' for referring bank

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[7] 71 Fed. Reg. 77522, 77533, citing 15 U.S.C. 78(c)(a)(4)(B)(i)(VI).
[8] Regulation B, 69 Fed. Reg. 39682, 39696.
[9] *Id*.
[10] 71 Fed. Reg. 77522, 77538.
[11] *Id*. at 77524.
[12] *Id.*
[13] *Id*.

customers to the broker-dealer if payment of the referral fee is not 'contingent on whether the referral results in a transaction.'"[14]

As demonstrated below, all three alternatives create an inappropriate incentive for retail bank employees who refer customers to broker-dealers.

Alternative One

The first alternative has the potential to pay certain bank employees more than double their hourly wages for each referred. For example: if a bank manager and a teller are in the same job family, the following is a possible breakdown of salary. The average hourly salary for a bank teller is $11.20 and the average hourly manager salary is $45.33.[15] Combined, the total is $56.53. The average of that combination is $28.26. As a result, this alternative provides a referral fee that more than doubles the base hourly rate of an average teller. A payment more than double an employee's hourly base salary is not "nominal."

Moreover, the proposed definition of "job family" is ambiguous. The proposed rule states, "[a] job family means a group of jobs or positions involving similar responsibilities, or requiring similar skills, education, or training that a bank, or a separate unit, branch or department of a bank, has established and uses in the ordinary course of its business to distinguish among its employees for purposes of hiring, promotion, and compensation."[16] Under this definition, a bank may place all non-registered employees in the same job family, which could lead to raising the average of either measure. This would result in a windfall for lower paid employees such as tellers, who have the majority of their daily interactions with retail bank customers.[17] Additionally, the definition is disjunctive and does not create a bright-line definition that banks can follow.

Alternative Two

In the second alternative, a fee that does not exceed twice the employee's actual base hourly wage could possibly mean a doubling, or multiplying of income.[18] Take the following example: A bank teller refers every person he sees in the day, which could exceed 30 people. Of those 30 people, 15 go to the broker (just to inquire). If the bank teller's hourly wage is $11.20,[19] the "nominal" referral fee could be up to $22.40 per

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[14] 15 U.S.C. 78c(a)(4)(B)(i)(IV).
[15] *See* U.S. Department of Labor, Bureau of Labor Statistics, *available at* http://www.bls.gov/ncs/ocs/sp/ncbl0832.pdf.
[16] 71 Fed. Reg. 77522, 77542.
[17] The first alternative allows for two different calculations: one is based on the average of the hourly wage and the other is based on 1/1000th of the average annual salary of the "job family." This would raise the average of either calculation within the first alternative. This allows banks the discretion to choose which employees are placed in similar "job families."
[18] This would occur if the banker referred every person and every person went to the broker regardless of the result of the meeting.
[19] *See* U.S. Department of Labor, Bureau of Labor Statistics, *available at* http://www.bls.gov/ncs/ocs/sp/ncbl0832.pdf.

referral. Therefore, in our example, this banker has made $11.20 an hour for that (8 hour) day equaling $89.60 and an extra $300.00 just in referral fees. This is more than a 300% gain in income for the day, just from referral fees.

Alternative Three

Finally, the third alternative represents a real increase in buying power for the average employee.[20] Assuming the employee receives the $25 flat rate referral fee, as little as five referrals a week would increase his salary by $125. If the employee can maintain this rate for a full year, he could increase his salary by $6,000.[21]

The Cumulative Effect of All Three Alternatives

The three alternatives are inconsistent with the "nominal" fee requirement because the actual value of the referral fee ignores the cumulative effect of making multiple referrals. All three proposed definition alternatives create the potential for banking employees to collect excessive referral fees.[22] This incentive is to the detriment of unsophisticated bank customers.

The cumulative effect of the referral fee could lead to a situation where a retail bank employee suggests to all banking clients with excess money in their accounts to make an appointment with a broker to obtain a return higher than what is offered in a traditional checking or savings account. In fact, many of the cases that SAC pursues involve situations where unsophisticated investors who have recently retired and have excess funds in their savings accounts are solicited by tellers or other retail bank employees to meet with a broker to obtain higher returns. Many of these brokers are not fixtures at the bank and travel around a specific territory. Under the current system, unsophisticated investors are unable to recognize the difference between banking employees and broker-dealer employees and brokers fail to explain adequately the increased risk of these products. These factors can contribute to the confusion that leads to brokers recommending unsuitable products to unsophisticated investors.

We simply do not believe that bank employees can successfully convince customers to use the broker's services without also selling the customer on the broker's products. While GLBA imposes some limitations on the activities of bank employees, the current regulatory structure does little to prevent bank employees from using sales

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[20] The yearly salary for this bank employee is $21,504; $6,000 is more than 33% of the salary.

[21] This assumes a 48-week year.

[22] The provision stating that, "[t]he fee could be paid to a bank employee no more than one time per customer referred by that employee," does not address the issue of cumulative fees because it does not deter the bank employee from encouraging every customer to meet with the broker-dealer. The current definitions actually encourage this behavior, especially when the referral fee is not contingent on an actual transaction taking place. *See* 15 U.S.C. 78c(a)(4)(B)(i)(IV). As the above-stated calculations indicate, it does not take a large number of willing customers to provide an employee with a worthwhile bonus. By simply approaching every new customer with whom he interacts, the employee increases his chances of earning a substantial bonus.

tactics to entice customers. Under the proposed alternatives, banker salesmanship poses a problem for small investors. Over a substantial period, such behavior could result in a bonus that is far from nominal. This degree of salesmanship is clearly beyond the intended scope of the referral fee contemplated by Congress.

Thank you for your consideration of these comments. Please do not hesitate to contact us if we can provide additional information.

Sincerely yours,

Jill I. Gross, Director
Reema Shah, Student Intern
Jonah Grossbardt, Student Intern