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March 30, 2007

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, D.C. 20551
Attention: Docket No. R-1274

Ms. Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090
Attention: File Nos. S7-22-06, S7-23-06

Re: Release No. 34-54946 (File No. S7-22-06): Regulation R
Release No. 34-54947 (File No. S7-23-06)

Ladies and Gentlemen:

The member banks of The Clearing House Association L.L.C.[1] ("The Clearing House") appreciate the opportunity to comment on the rules proposed (the "Proposed Broker Rules") by the Board of Governors of the Federal Reserve System (the "Board") and the Securities and Exchange Commission (the "Commission", together with the Board, the "Agencies") under the Securities Exchange Act of 1934 (the "Exchange Act") as modified by the Gramm-Leach-Bliley Act (the "GLBA") and that are proposed to be contained in a new Regulation R. The Proposed Broker Rules define the

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[1] The member banks of The Clearing House are: Bank of America, National Association; The Bank of New York; Citibank, N.A.; Deutsche Bank Trust Company Americas; HSBC Bank USA, National Association; JPMorgan Chase Bank National Association; LaSalle Bank National Association; UBS AG; U.S. Bank National Association; Wachovia Bank, National Association; and Wells Fargo Bank, National Association.

terms of certain statutory exceptions for banks from the definition of "broker" in Section 3(a)(4) of the Exchange Act and provide additional regulatory exemptions from that definition. The Clearing House appreciates the Agencies' solicitation of comments in the proposing release[2] (the "Release") and the opportunity to provide comments on the Release and the Proposed Broker Rules. We also are pleased to provide our comments on the Commission's related proposed rules[3] (the "Proposed Dealer Rules", and together with the Proposed Broker Rules, the "Proposed Rules") concerning exemptions for banks from the definition of "dealer" under Section 3(a)(5) of the Exchange Act.

We appreciate the Agencies' efforts to address the concerns expressed by The Clearing House member banks and other commentators that the proposed rules issued by the Commission in late 2004 implementing certain provisions of Title II of the GLBA,[4] incorporated in a new proposed Regulation B ("Proposed Regulation B"), were overly prescriptive and burdensome. We believe that the Agencies have successfully resolved many of our prior concerns and that the Proposed Rules represent a substantial improvement over Proposed Regulation B and the interim rules the Commission adopted in 2001[5] (the "Interim Final Rules"). We nevertheless believe that the Proposed Rules do contain provisions that unduly burden banks without any real corresponding public policy benefit, such as additional protection for investors, and that in some cases further clarification is necessary.

One general point that we wish to make regarding implementation of Title II of the GLBA is that traditional bank activities may qualify for more than one statutory exception (or regulatory exemption). In order to provide banks with legal certainty, we urge the Agencies to confirm what we believe is clear under the statute and the Proposed

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2 Release No. 34-54946, 71 Fed. Reg. 77,522 (Dec. 26, 2006).

3 Release No. 34-54947, 71 Fed. Reg. 77,550 (Dec. 26, 2006).

4 Release No. 34-49879, 69 Fed. Reg. 39,682 (June 30, 2004).

5 Release No. 34-44291, 66 Fed. Reg. 27,760 (May 18, 2001).

Rules, that, except as provided in Proposed Rule 760(d)(1), when more than one statutory exception under Section 3(a)(4)(B), (C), or (D) or under Section 3(a)(5)(C) of the Exchange Act or exemption under the final rules implementing those sections is available, a bank should be able to make its own decision regarding on which exception or exemption it intends to rely, and that the different exceptions and exemptions are not mutually exclusive. For example, a bank that provides fiduciary services to its customers but does not effect any securities transactions itself other than to sweep fiduciary funds into money market mutual funds might decide to rely on the sweep exception rather than the fiduciary exception. Or, a bank that provides custody services and executes orders for exempted securities could rely either on the exception in Section 3(a)(4)(B)(iii) of the Exchange Act or on Proposed Rule 760. Or, a bank that serves as an IRA trustee for an account but provides only custodial services could rely on either the fiduciary exception or the custody and safekeeping exception. Similarly, if a bank provides custody and safekeeping services to a fiduciary account at the bank and charges for the two types of services separately, it should be permitted to include the custody revenue from the account in the "chiefly compensated" calculations.

This point is of critical importance to banks, because many bank activities could be said to fall under more than one exception or exemption. Banks cannot be in the position of having to comply with the most restrictive set of conditions under which any particular activity may be conducted.

We also urge the Agencies to agree formally to consult with each other when issues of interpretation of any aspect of Section 3(a)(4)(B), (C), or (D) or Section 3(a)(5)(C) of the Exchange Act, their implementing regulations or related issues arise, including in the context of administrative actions by the Commission, such as cease and desist orders. Such consultation is important even in the context of administrative actions that do not arise directly from these two sections, because the Commission and others look to statements made in administrative actions as precedent in interpreting the

Exchange Act.[6] In order to avoid misunderstandings, both from the securities and bank regulatory perspectives, we encourage the Agencies to commit to consult one another whenever such interpretive issues are present.

We have reviewed the letters of comment submitted by the American Bankers Association and its affiliate the ABA Securities Association (the "ABA/ABASA Letter") and the Institute of International Bankers (the "IIB Letter") and wish to note our general support for the comments these two industry associations have made.

Our specific comments on the Proposed Rules are set forth below.

I. Employee Compensation for the Referral of a Customer to a Registered Broker or Dealer

We appreciate many of the provisions of the Proposed Rules clarifying the circumstances under which a bank may pay referral fees to unlicensed bank employees. We also appreciate the Agencies' recognition that banks need flexibility in order to appropriately structure employee compensation and bonus plans to attract and retain talent. We are concerned, however, that certain provisions of the Proposed Rules implementing the networking exception fail to take account of accepted bank compensation practices or unduly restrict those practices.

A. Networking Exception: Referral Fees

1. Definition of "Contingent on whether the referral results in a transaction" (Proposed Rule 700(a))

Section 3(a)(4)(B)(i) of the Exchange Act permits bank employees to receive nominal fees for referring customers to a broker-dealer without the bank or the

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[6] We are concerned by the Commission's statement, in a recent cease and desist order, that "like IRAs, revocable trusts are generally not established for a fiduciary purpose", as well as by the Commission's reliance on certain statements made in the release accompanying the Interim Final Rules. See In the Matter of Dunham & Associates, et al., Release No. 33-8740 (Sept. 22, 2006). Although we do not necessarily disagree with the actions taken by the Commission in the case, we are concerned that these statements, which were not necessary to the Commission's conclusions, may have raised questions about the status of traditional bank activities under Section 3(a)(4)(B).

employees being required to register as a broker so long as the fees are not "contingent on whether the referral results in a transaction". Under Proposed Rule 700(a), a referral fee would be considered "contingent on whether the referral results in a transaction", and therefore impermissible under the networking exception, if the referral fee depends on "whether an account is opened with a broker or dealer".

We request that Proposed Rule 700(a) be amended to remove the presumably unintended implication that a referral fee may not be conditioned on opening an account at a broker-dealer even if the account would not involve securities transactions. Further, we request that the Proposed Rule be amended to clarify that a referral fee may be conditioned on opening an account at a broker-dealer to conduct transactions that, if conducted at the bank, would not require the bank to register as a broker-dealer. We believe that it is clear that neither Congress nor the Agencies intended that the networking exception or the Proposed Rules restrict referrals for transactions not involving securities and not involving transactions that a bank could conduct without being required to register as a broker-dealer.[7]

We therefore believe that the Proposed Rule should be revised to read as follows: "Contingent on whether the referral results in a transaction means dependent on whether … an account is opened with a broker or dealer in which account the person may conduct securities transactions that may not be conducted through a bank (other than pursuant to Section 3(a)(4)(B)(xi)) without the bank being required to register as a broker or dealer under the Exchange Act".

We further note that clause (a)(2) of this definition permits a bank referral fee program to use qualification criteria that the bank or broker or dealer "may have established generally for referrals for securities brokerage accounts" (emphasis added).

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7 See 71 Fed. Reg. at 77,528 ("[T]he networking exception and the proposed rules do not apply to referrals of retail, institutional or high net worth customers to a broker or dealer or other third party solely for transactions not involving securities, such as loans, futures contracts (other than a security future), foreign currency, or over-the-counter commodities.").

We agree that banks should be able to condition a referral on such criteria, and believe that the use of the word "generally" was intended to make clear that a bank may not establish different criteria for different specific employees, and that the word was not intended to call into question qualifications established for groups or classes of bank employees (e.g., tellers, loan officers or employees of a particular geographic or business unit).

We agree with the Agencies' decision to allow a referral fee to be conditioned on a customer's keeping an appointment with a broker-dealer as a result of a referral.

2. *Definition of "Nominal one-time cash fee of a fixed dollar amount" (Proposed Rule 700(c))*

We appreciate the Agencies' efforts to accommodate various categories of employees and levels of compensation in the Proposed Rule regarding referral fee payments (e.g., calculation based on job family). We continue to believe, however, that the $25 standard that the Agencies have established is inappropriately low. We realize that the Agencies have attempted to address this concern by creating alternative standards and do not object to reliance on alternative standards provided that those standards address the variations that exist across geographic regions and job types. In general we believe that the Agencies have done a reasonable job of addressing those variations.

In one respect, however, we believe that change is necessary. Proposed Rule 700(c) uses "base" salary or "base hourly wage" as the basis for calculating permissible referral fees under certain of the alternatives it creates. We believe that this approach unfairly discriminates against employees who receive a significant portion of their compensation in forms other than base salary or base hourly wage. We therefore believe that base salary and base hourly wage should be replaced by the concept of total compensation (other than from referral fees payable under Section 3(a)(4)(B)(i) or Proposed Rule 701). This is more consistent with the ways in which many financial holding companies view compensation in managing their businesses.

In addition, we note that banks sometimes pay referral fee using programs that are based on a points system. That is, a bank employee receives a cash payment in respect of referrals only after she or he has accumulated the requisite number of points. The actual payment may be in an amount greater than the maximum permissible fee for a single referral, because it is a payment in respect of a number of referrals. Provided that the other conditions applicable under the statute and Proposed Rule 700 are met, we believe that points programs of this sort (or other programs that only pay a referral fee if an employee achieves some threshold) should be and are permissible. These programs can be simpler to administer and are not subject to manipulation.

Finally, we agree with the Agencies' confirmation in the Release that the "one time" requirement applies per referral, not per customer. The contrary approach would not be consistent with the GLBA and would be unworkable.[8]

3. Definition of "Referral" (Proposed Rule 700(e))

Proposed Rule 700(e) defines "referral" as "the action taken by a bank employee to direct a customer of the bank to a broker or dealer for the purchase or sale of securities for the customer's account". The corresponding language in Exchange Act Section 3(a)(4)(B)(i)(VI) states that "bank employees may receive compensation for the referral of any customer", without referring to a person[9] being a customer of the bank. The Clearing House assumes that the Agencies did not mean by the addition of the words "of the bank" to suggest that a person who or which has not yet established an account at the bank would not be a "customer" for purposes of the Proposed Rule. We believe that the statutory purpose of the networking exception would be best served by treating any person with whom a bank employee may come into contact as a "customer". As the Agencies are aware, banks provide products and services to ever changing groups of

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[8] See 71 Fed. Reg. at 77,524 ("A bank employee may receive a referral fee under the networking exception and Proposed Rule 700 for each referral made to a broker-dealer, including separate referrals of the same individual or entity.").

[9] When we refer to "persons" in our discussion in this section, we mean both natural persons and entities.

persons. They are always seeking out new persons with whom to do business. We believe that when Congress was drafting the networking exception, Congress considered any person who visits a bank or to whom a bank employee markets products or services to be a "customer" for purposes of the exception. We therefore request that the Agencies clarify that they did not intend any such result by adding the words "of the bank".

B. Payment of Incentive Compensation in Connection with Transactions in Certain Instruments

Section 3(a)(4)(B) of the Exchange Act provides exceptions from the definition of broker for a bank that effects transactions in connection with certain types of securities. For example, Section 3(a)(4)(B)(iii) permits a bank to effect transactions in commercial paper, bankers acceptances, commercial bills, exempted securities, certain Canadian government obligations and "Brady bonds". Similarly, Section 3(a)(4)(B)(ix) permits transactions in "identified banking products" and Section 3(a)(4)(B)(x) permits transactions in municipal securities (which are also permitted under Section 3(a)(4)(B)(iii)). A bank seeking to rely on certain of these exceptions must, to the extent applicable, comply with other requirements under the Exchange Act, the rules of the Municipal Securities Rulemaking Board, or various rules under the Government Securities Act of 1986.

Congress clearly viewed a bank's effecting transactions in these instruments as a traditional banking activity, and therefore such activities do not subject a bank to the Exchange Act's broker registration requirements. We believe that a bank should be able to pay incentive compensation to its employees in connection with referrals to a broker-dealer that result in the broker-dealer effecting transactions in such instruments without the bank's being required to register as a broker. We believe that if the activity is one in which the bank could itself engage without registering as a broker, its referral activities with respect to the same activity should not trigger the broker registration requirement. We suggest revising Proposed Rule 700 to add a new subsection that defines "brokerage transaction for purposes of Section 3(a)(4)(B)(i)(VI)"

as "a transaction that, if conducted by a bank, would not be eligible for one of the exceptions in Section 3(a)(4)(B)(iii), (ix) or (x)".

C. Networking Exception: Bonus Plans

1. Definition of "Incentive Compensation" (Proposed Rule 700(b))

a. Compensation Based on Multiple Factors (Proposed Rule 700(b)(1))

We appreciate the Agencies' solicitation of comments on the effects of Proposed Rule 700 on existing bonus plans. Bank bonus plans generally feature bonuses that are paid on a discretionary basis using several measures of an employee's performance, some of which are subjective and some of which are objective. Clear and consistent interpretation of Proposed Rule 700(b)(1) will be absolutely critical to the overall compensation schemes of banks and their non-broker-dealer affiliates. We strongly agree with the interpretation of the Proposed Rule articulated in the ABA/ABASA Letter and voice our support for the views on this subject as set forth therein, which we understand to be consistent with the views of the Agencies.

b. Compensation Based on Overall Profitability (Proposed Rule 700(b)(2))

Proposed Rule 700(b)(2) permits banks to pay compensation based on "any measure of overall profitability" of a bank, non-broker-dealer affiliate or unit, or a broker-dealer so long as, in the case of compensation based on the profitability of a broker-dealer, there are multiple factors used to determine the compensation, which include significant factors or variables that are not related to the profitability of the broker-dealer.

Banks often use factors other than "overall profitability" to set compensation targets or otherwise to make compensation decisions. For example, a bank may choose to pay compensation to its officers, directors or employees based on total

revenue, changes in revenue, changes in the company's stock price or earnings per share, or numerous other measures of financial performance. The Clearing House is concerned that Proposed Rule 700(b)(2) might be read to suggest that compensation paid to an employee based on changes in total revenue, the stock price of the bank or its parent, or some other such variable, constitutes "incentive compensation" because it is not based on "overall profitability" of one of the identified entities. Such an interpretation might have the effect of making the networking exception unavailable for banks using bonus plans based on factors not related to overall profitability because a bank generally "may not pay its unlicensed employees incentive compensation for referring a customer to the broker-dealer or for any securities transactions conducted by the customer at the broker-dealer".[10] Therefore, it is our view that the safe harbor for compensation based on "overall profitability" is too narrow because it fails to include measures of a bank's performance that are frequently used in practice and are not intended to provide an incentive to refer business to broker-dealers.

We therefore suggest that the term "the overall profitability" in the introductory sentence of Proposed Rule 700(b)(2) and the term "the profitability" in Proposed Rule 700(b)(2)(iii)(B) be replaced by the term "the financial performance", and that the term "Such profitability" in Proposed Rule 700(b)(2)(iii)(A) be replaced by the term "Such measure of financial performance".

c. Compensation Based on Operating Units (Proposed Rule 700(b)(2))

Under Proposed Rule 700(b)(2)(ii), a bank may pay compensation to its unlicensed employees based on the overall profitability of "any of the bank's affiliates (other than a broker or dealer) or operating units". A bank may thus structure its bonus plans to meet the different needs of operating units of the bank engaged in different activities or located in different geographic regions. We are concerned, however, that the language regarding operating units might be read not to apply to operating units of

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[10] Id. at 77,524.

affiliates, and it appears that the Proposed Rule may not allow taking into account operating units of a broker-dealer. We see no reason why a bank should not be afforded the same flexibility when it pays compensation to its employees based on the financial performance of an affiliate, including a broker-dealer affiliate.

We therefore urge the Agencies to revise the language in Proposed Rule 700(b)(2)(ii) to read: "Any of the bank's affiliates (other than a broker or dealer) or any operating unit of the bank or of such an affiliate;". We further urge that Proposed Rule 700(b)(2)(iii) be revised to read as follows: "A broker or dealer, or any operating units of a broker or dealer, if …".

D. Networking Exception: Exemption for Certain Institutional Referrals

Proposed Rule 701 provides an exemption from the limitations on incentive compensation set forth in Section 3(a)(4)(B)(i)(VI). Under this exemption, an unlicensed bank employee may receive a referral fee greater than would be permissible under the networking exception for referring a high net worth or institutional customer to a broker-dealer so long as certain conditions are met.

The Clearing House appreciates the Agencies' proposal of an exemption permitting the payment of a contingent, greater than nominal referral fee to an unlicensed bank employee for the referral of sophisticated persons to a broker or dealer. This issue has been a matter of particular concern to The Clearing House member banks, and The Clearing House previously proposed such an exemption to the Commission's staff in discussions after the release of the Interim Final Rules, a proposal we reiterated in our comments on Proposed Regulation B. We believe that such an exemption is appropriate as a matter of public policy.

We are concerned, however, that the exemption under Proposed Rule 701 will be of limited use to banks because banks would have to incur significant administrative costs, otherwise unnecessary, in order to ensure compliance with the conditions under this exemption.

The Clearing House urges the Agencies give greater weight to the fact that any transactions arising from referrals by an unlicensed bank employee under Proposed Rule 701 will be effected by a registered broker-dealer, and will be subject to the supervisory framework established by the broker-dealer consistent with the rules of the Commission and the applicable self-regulatory organization ("SRO"). Moreover, the broker-dealer itself will be subject to oversight and regulation by the applicable SRO and by the Commission. The high net worth or institutional customer thus will be more than adequately protected as a result of the broker-dealer's supervisory framework and the rules and regulations that govern the conduct of securities transactions at the broker-dealer. We believe that the mere fact that the bank employee made a referral and will receive a contingent, non-nominal referral fee does not mean that the existing investor protection and other securities supervisory measures are inadequate. We believe that this is especially true when one considers that this exemption will apply only to referrals of sophisticated persons, who are "more likely to be able to understand and evaluate the relationship between the bank and its employees and its broker-dealer partner"[11] when provided with the appropriate information.

We therefore urge the Agencies to consider revisions to this exemption such that banks are provided with greater flexibility and less significant compliance burdens. Our specific suggestions are outlined below.

1. Requirements Imposed on the Bank Employee (Proposed Rule 701(a)(1))

One of the conditions for this exemption is that the high net worth or institutional customer being referred to a broker-dealer "is encountered by the bank employee in the ordinary course of the employee's assigned duties for the bank".[12] We are concerned that this language will create numerous interpretive questions and may

[11] 71 Fed. Reg. at 77,525.

[12] Proposed Rule 701(a)(1)(ii).

make seemingly arbitrary factors determinative of whether a bank employee will be eligible to receive such a referral fee.

For example, if a bank employee meets a high net worth individual or officer of an institutional customer at a private function such as a cocktail party and subsequently refers this high net worth individual or institution to a broker-dealer, Proposed Rule 701(a)(1)(ii) arguably would preclude the bank from relying on the high net worth or institutional customer exclusion from the prohibition on paying a greater than nominal referral fee for this particular referral unless the bank has explicitly instructed its employees that they are to seek out potential customers at all times, including at private social functions. Whether a bank has given its employees such instructions hardly seems an appropriate factor for deciding whether an institutional referral fee may be paid.

A second ambiguity arises if a bank employee knew the prospective customer prior to joining the bank, whether through a personal contact or through a business contact at a prior employer. It seems arbitrary that a bank employee may receive a referral fee for referring a customer that the employee met after joining the bank, but not for one that he or she knew prior to joining the bank. Given the current mobility of the labor market, such a requirement seems particularly inappropriate.

Finally, it is often difficult to pinpoint when or how a bank employee first "encounters a prospective customer", and bank employees often seek business in informal, unofficial fora. Requiring banks to determine and monitor the ways in which their employees meet each particular customer will impose an almost insurmountable burden on banks, and we believe that this requirement will make Proposed Rule 701 of only limited utility to banks. Moreover, we do not believe this requirement provides any real public policy benefit.

The Clearing House recognizes that the Agencies are concerned that unlicensed bank employees not engage in improper conduct. We believe, however, that

the Agencies' concern is more than adequately addressed by the other conditions that we believe should be retained in Proposed Rule 701, particularly the requirements that the bank employee not be otherwise required to be qualified pursuant to SRO rules, that the bank employee be engaged predominantly in banking activities other than making referrals and that the employee not be subject to a statutory disqualification. We think it is unnecessary separately to restrict the manner in which unlicensed bank employees encounter or meet high net worth or institutional customers. We therefore urge that the condition imposed in Proposed Rule 701(a)(1)(ii) be removed to lessen the compliance burden on banks. We believe that this can be done without the loss of any measurable public policy benefit.

2. *Obligations Imposed on the Bank (Proposed Rule 701(a)(2))*

a. Disclosures (Proposed Rule 701(a)(2)(i))

Under Proposed Rule 701(a)(2)(i), a bank is required to make certain disclosures "[p]rior to or at the time of the referral". We are concerned that this requirement will create numerous difficult interpretive questions and potentially arbitrary results, again without resulting in any public policy benefit. We therefore believe that the Proposed Rule should be changed to require the necessary disclosures be made at or prior to the time that the broker-dealer effects the securities transaction for the customer.

The term "referral" is not defined in Proposed Rule 701, but, as noted above, it is defined in Proposed Rule 700 as "the action taken by a bank employee to direct a customer of the bank to a broker or dealer for the purchase or sale of securities for the customer's account". This definition creates a somewhat elastic concept, which elasticity does not raise issues in the context of Proposed Rule 700, but can raise serious issues in the context of Proposed Rule 701. Does the mere mention by a bank employee to a customer that the bank has a broker-dealer affiliate mean that the referral has occurred? Or is the referral the act of giving the name of the broker-dealer, or of a contact person at the broker-dealer, to the customer? Or does a referral occur only if the

bank employee gives the customer's name to the broker-dealer affiliate? If a customer asks an unlicensed bank employee whether the bank has a broker-dealer affiliate or whether it can conduct a securities transaction, is there anything helpful that the employee can say in response that would not constitute a referral? Given the requirement of clause (2)(i) of the Proposed Rule, it will be critical for the bank to know exactly when a referral is deemed to occur, but in many circumstances this will be almost impossible for the bank to determine as a legal matter given the ambiguity inherent in the definition.

Depending on when a referral is deemed to occur, bank employees may be required to provide disclosures to high net worth and institutional clients at awkward or inappropriate times. Imagine a bank client who asks his or her banker about a possible investment banking transaction at a social engagement. Must the banker refuse to say anything in response because he or she does not have the disclosure documentation handy?

We do not think that it would be useful (or even possible) to resolve these issues by trying to define more precisely when a "referral" occurs. Rather, we believe that the policy goals behind the disclosure requirement can be completely satisfied by requiring that disclosure occur at or prior to the time the broker-dealer effects the securities transaction for the customer.

b. Determining Customer Qualification (Proposed Rule 701(a)(2)(ii))

Under Proposed Rule 701(a)(2)(ii), different standards apply to natural persons and other customers when assessing whether the customer is the sort of customer that may be the subject of a higher than nominal or contingent referral fee under Proposed Rule 701. We believe that this distinction is unnecessary and that the Proposed Rule's requirement that the determination be made before a referral fee is paid in respect of an institutional customer is sufficient to achieve the Agencies' purposes with respect to high net worth customers as well.

For the same reasons that we are concerned with the requirement that disclosures be made prior to or at the time of the referral, we are concerned about the feasibility of the requirement under Proposed Rule 701(a)(2)(ii)(B), that a bank, "prior to or at the time of the referral", either determine whether a natural person is a high net worth customer or obtain a signed acknowledgment from the customer that the customer meets the standards for a high net worth customer. As noted above, when a referral occurs is not certain, which will raise interpretive questions and create awkward situations.

The requirement creates a seemingly arbitrary result -- that whether a higher than nominal referral fee is payable may be determined by the order in which an employee and the customer discuss topics. For example, if a bank employee meets with a natural person to discuss banking products or services and the customer expresses an interest in securities products before there is any discussion of the customer's financial means, it would be natural for the bank employee to indicate that the bank has a broker-dealer affiliate and provide contact information for that affiliate. Doing so at this point in the conversation, however, would mean that the employee is not eligible for a higher than nominal referral fee. Requiring the employee instead first to inquire about the customer's financial means and only then to mention the broker-dealer affiliate, seems to serve little policy purpose and indeed will create an incentive for unlicensed employees to be delving into matters that may not be relevant to the banking business that the employee is supposed to be conducting.

These difficulties are not solved by the alternative of obtaining a signed acknowledgment from the customer that the customer meets the high net worth definition. This alternative puts bank employees in the position of seeking to have high net worth customers sign such acknowledgements before any discussion of the fact that the bank has a broker-dealer affiliate can occur. Again, this will lead to artificial and awkward interactions between bank employees and customers. Moreover, we believe

that burdening bank customers with additional paperwork in order for the bank to be eligible for this exemption is unreasonable and unnecessary.

We therefore urge that the Agencies eliminate clause (ii)(B) and apply clause (ii)(A), which requires only that the bank make the determination prior to paying a referral fee under the Proposed Rule, to natural persons as well as to institutional customers, or require that either the bank or broker-dealer make the determination prior to the time the broker-dealer effects a securities transaction for the customer.

c. Determining Employee Qualification (Proposed Rule 701(a)(2)(iii))

Proposed Rule 701(a)(2)(iii) requires a bank, before a referral fee can be paid, to provide information about the bank employee to the broker-dealer so that the broker-dealer may independently assess whether the bank employee is subject to a statutory disqualification under Section 3(a)(39) of the Exchange Act. We do not believe duplicative assessments by the bank and the broker-dealer should be required. Banks and broker-dealers should be allowed to decide between themselves how to divide responsibility for making the determination that the employee is not associated with a broker-dealer and is not otherwise subject to statutory disqualification as defined in Section 3(a)(39) of the Exchange Act. Each should be permitted to rely on the determination made by the entity to which they have jointly assigned this responsibility, provided that the entity agrees to share the necessary information in the event that the other entity needs it for its own purposes or in order to satisfy its regulators. Requiring duplicative determinations of the bank employee's qualifications would add to the compliance burden of both the bank and the broker-dealer. We believe that this duplicative effort is unnecessary and adds an extra layer of complexity for relief under this exemption. We respectfully urge the Agencies to remove this requirement and provide that banks and broker-dealers may divide these responsibilities between themselves as they see fit, subject to having adequate access to the information regarding such determinations.

d. Compliance and Corrections (Proposed Rule 701(a)(2)(iv))

Proposed Rule 701 includes a requirement that a bank make "reasonable efforts" to reclaim from a bank employee who received a referral fee under the Proposed Rule that is later determined not to have been permitted the impermissible portion of the referral fee. Although such a requirement may have appeal when considered at first blush, on further consideration we believe that it is not good public policy. First, if the person who was referred did not in fact qualify as a "high net worth customer" or "institutional customer", that fact may not be the fault of the bank employee. Employees are likely to react very negatively to being asked to return compensation that they accepted in good faith, especially when the employee has done nothing wrong, even when her or his conduct is reviewed with 20/20 hindsight.

Moreover, the very existence of this requirement may create a cloud over this type of referral fee in the minds of bank employees. It is not normal for part of an employee's compensation to be subject to being reclaimed, and bank employees will be uncertain of when or whether they can use this compensation. This requirement creates a cloud of uncertainty around legitimately earned pay. At what point could the employee feel confident in his or her earnings?

Finally, we are concerned about the phrase "reasonable efforts". Given that the effort will be to get funds back from an employee, we are concerned that it will be difficult for banks to have legal certainty regarding what sort of efforts are necessary to satisfy this requirement. We do not see the need to put banks in this position.

For all these reasons, we urge the Agencies to remove this requirement from the Proposed Rule. Doing so will not, of course, in any way eliminate the other enforcement tools the Agencies have under the various statutes that they administer.

3. *Provisions of Written Agreement* (*Proposed Rule 701*(*a)(3)*))

a. Customer and Employee Qualifications (Proposed Rule 701(a)(3)(i))

As noted above, The Clearing House believes that the exemption under Proposed Rule 701 could be simplified so that banks would not have to incur unnecessary compliance costs. We believe that high net worth and institutional customers, when provided with adequate disclosure such as is required under Proposed Rule 701(a)(2)(i), are sophisticated enough to understand the relationship among the bank, its employees and any broker-dealer. Therefore, we believe that the Agencies should revise Proposed Rule 701(a)(3)(i) to allow a bank and a broker-dealer to allocate compliance responsibilities between themselves through an agreement that is not statutorily mandated.

Should the Agencies determine, however, to retain this regulatory restriction on the allocation of compliance responsibilities between the bank and a broker-dealer, we request that the Agencies adopt the following amendments to Proposed Rule 701(a)(3).

Under the first prong of Proposed Rule 701(a)(3)(i), "[t]he bank and broker or dealer must determine that the bank employee is not subject to statutory disqualification" (emphasis added). As stated above, we believe that broker-dealers and banks should be able to decide for themselves how to divide responsibility for the determination as to whether the bank employee is subject to statutory disqualification. There are many instances under relevant law under which an entity may rely upon an affiliate's or other third party's assessments, e.g., Customer Identification Programs under the USA Patriot Act of 2001 and its implementing regulations.[13] There is no reason why the same determination must be made by both the bank and the broker-dealer. The duplicative effort would increase compliance costs for all the parties involved and

[13] See, e.g., 31 C.F.R. § 103.121.

provide no added benefit or protection to the customers. We respectfully urge the Agencies to revise the language in Proposed Rule 701(a)(3)(i)(A) to read as follows: "The bank or broker or dealer must determine that the bank employee is not subject to statutory disqualification, as that term is defined in section 3(a)(39) of the Act".

For the same reason, we believe that the second prong of this requirement should be eliminated. Of course a determination needs to be made that the customer is a high net worth or institutional customer in order for a bank to rely on this exemption, but there is no reason why a broker-dealer must duplicate the effort made by a bank or vice versa. A bank and a broker-dealer should be permitted to rely upon the other's determination as to the eligibility of the customer for the same reasons as set forth above. Therefore, we request that the language in Proposed Rule 701(a)(3)(i)(B) be revised as follows: "Either the broker-dealer or the bank must determine that the customer is a high net worth customer or an institutional customer".

b. Suitability or Sophistication Analysis by the Broker-Dealer (Proposed Rule 701(a)(3)(ii))

Under Proposed Rule 701(a)(3)(ii), the written agreement between the bank and the broker-dealer must provide for the broker-dealer to perform a suitability analysis of the securities transaction if the referral fee is contingent on the completion of the securities transaction. The Release states that in the case of contingent referral fees, the broker-dealer must conduct a suitability analysis "of any securities transaction that triggers any portion of the contingency fee … as if the broker or dealer had recommended the securities transaction" before the securities transaction may be conducted.

The Clearing House is concerned that this requirement is overbroad and imposes an unnecessary burden on the broker-dealer. For example, a mutual fund client of a bank might indicate to an unlicensed bank employee that it is interested in learning about the ability of the bank's affiliated broker-dealer to execute the purchase or sale of a block of securities. The bank employee would normally refer the mutual fund to the broker-dealer affiliate and might be eligible for a referral fee under Proposed Rule 701.

Under the Proposed Rule, the broker-dealer must conduct a suitability analysis of the transaction in accordance with the broker-dealer's applicable SRO, even if the securities transaction would not otherwise require such suitability evaluation under the requirements of the SRO because it was not solicited by the broker-dealer.[14] We presume that this suitability determination was intended to be made prior to the broker-dealer effecting the transaction, which for some unsolicited transactions for institutional customers may not be practical given the broker-dealer's best execution duties and the customer's expectations regarding timing.

We believe that this additional suitability test is unnecessary. The SROs have rules that determine when a suitability determination is appropriate. There is no need to change those rules just because a bank employee made the referral. Therefore, we respectfully urge that the Agencies revise Proposed Rule 701(a)(3)(ii)(A) to eliminate the requirement that the broker-dealer perform a suitability analysis of the securities transactions not required by applicable SRO rules.

We also believe that the alternative requirement (applicable under the Proposed Rule only to non-contingent referral fees) that the broker-dealer make a "sophistication" analysis is unnecessary and burdensome. It seems particularly inappropriate when the transaction that led to the referral fee is an investment banking transaction. We would therefore eliminate this requirement.

4. Definitions (Proposed Rule 701(d))

a. High Net Worth and Institutional Customer (Proposed Rule 701(d)(1) and (2))

Proposed Rules 701(d)(1) and (2) define the monetary threshold that a customer must meet in order to be considered a high net worth or institutional customer. These definitions are different from other definitions that measure the sophistication of investors under the federal securities laws. We believe that creating an entirely new set

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[14] By definition, the transaction will not have been solicited by the bank employee.

of standards to measure the sophistication of customers will increase the compliance burden of banks without a corresponding increase in investor protection.

The Clearing House suggests that the Agencies revise Proposed Rule 701(a) by replacing the criteria contained therein with the criteria contained in the definition of "accredited investor" contained in Rule 501(a) of Regulation D under the Securities Act of 1933 (the "Securities Act") and by including two additional categories of sophisticated persons.[15] First, we believe entities that are controlled by persons who qualify as accredited investors or advised by a registered investment adviser or a bank should be treated as sophisticated customers for purposes of this Proposed Rule. Persons who are sophisticated enough to evaluate the risks of privately placed securities and who do not need the protections of registration under the Securities Act surely can understand the relationship among a bank, its employee and a broker-dealer in these circumstances. We also believe that persons who are controlled by an accredited investor or have the financial or investment experience to hire professional advisors are similarly sophisticated.

In addition, we believe that it would be appropriate that Proposed Rule 701(d) be revised to include any entity with $5 million or more in annual revenues. This revision would capture a category of customers that banks currently identify as sophisticated users of banking products and services, and treating such customers as sophisticated customers would ease banks' compliance burdens without sacrificing customer protections. In the banking industry, a common and accepted measure of the size and sophistication of corporate and commercial customers is their total annual revenues. Banks frequently use the level of a corporate or commercial customer's revenues as a measure of categorizing such customers. Therefore, this revision would reduce the compliance burden on banks in evaluating the sophistication of institutional

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[15] We recognize that the Commission has proposed changes to the definition of "accredited investor" (Release No. 33-8766, 72 Fed. Reg. 400 (Jan. 4, 2007)) and although we do not endorse all aspects of the recent proposed changes to the definition, we believe that there are advantages to incorporating a standard with which securities professionals and the market are familiar.

customers and would not, we believe, diminish the Agencies' goal in providing these guidelines. We believe it is appropriate to include this additional category of institutional customers whether or not the Agencies revise these definitions more generally as we suggest.

If the Agencies determine not to implement our suggestions above, we urge the Agencies to amend the assets threshold in Proposed Rule 701(d)(2)(ii) to $5 million in assets. We strongly believe that an entity that has either $5 million in sales (as discussed above) or assets possesses sufficient sophistication to understand the relationships at issue in this Proposed Rule.

If the Agencies do not adopt the standards we propose above, we believe it is appropriate for the Agencies to change the definition of institutional customer to provide that referrals of entities with $5 million in assets for investment banking services and referrals of entities with $10 million in assets for all other services are permissible. The threshold for institutional referrals generally is simply too high and the Proposed Rule as drafted excludes a significant range of customers that possess the expertise to evaluate the required disclosures and their meaning. In addition, there will be instances in which a customer is a newly formed entity with a need for investment banking services or a small company wishing to access the capital markets for the first time. These customers will have difficulty satisfying the $25 million in assets threshold yet are sufficiently sophisticated to understand the relationship between a bank and a broker-dealer, especially given that they will be provided with adequate disclosure.

In addition to the above comments on Proposed Rule 701, we believe that the Proposed Rule does not adequately provide for charitable organizations and municipalities. These entities require brokerage and investment banking services, and although they may not meet the dollar thresholds set in the definition of institutional customers, they often have in-house experts or other advisors to guide them in their financial decisions. Thus, we support the position taken in the ABA/ABASA Letter that when a charitable organization or municipality has the investment expertise required to

understand the relationship among a bank, a referring bank employee and a broker-dealer, there is no reason the charitable organization or municipality should have to meet a high net worth or asset requirement.[16]

b. Investment Banking Services (Proposed Rule 701(d)(3))

The Clearing House believes that the Agencies should expand the definition of "investment banking services" under Proposed Rule 701(d)(3) specifically to include acting as an underwriter in a secondary offering of securities and as a financial adviser in a divestiture. Although we recognize that the list of services in the Proposed Rule's definition is non-exclusive, we believe that adding these common investment banking services to the definition will provide added legal certainty.

c. Referral Fees (Proposed Rule 701(d)(4))

The Clearing House believes that the restrictions on referral fees payable for the referral of sophisticated persons to a broker or dealer are not necessary. As noted above, this exemption permits the payment of contingent, more than nominal referral fees to bank employees referring high net worth and institutional customers to a broker-dealer. We believe that the conditions to this exception could be simplified without any loss of protection for such customers. We respectfully submit that it should be sufficient to define the appropriate categories of customers who possess the requisite sophistication to understand the relationship between the bank and the broker-dealer, and the import of the type of referral fee, and to provide for disclosures of such relationships.

The Clearing House believes that so long as the relationship between the bank and the broker-dealer and the details of a referral fee program are disclosed, the type of referral fee that is paid should be determined as part of the agreement between the bank and the broker-dealer governing the networking relationship, in order to promote

[16] In addition, the final version of Proposed Rule 701 needs to address newly formed subsidiaries and joint ventures that are too new to meet whatever standards the Agencies set for sophistication.

the most efficient allocation of resources, thereby furthering the purposes of the GLBA. We would emphasize that any transaction that would be effected subsequent to a referral to a broker-dealer would be conducted by the broker-dealer in accordance with all of the rules and regulations applicable to the broker-dealer. Consequently, all of the investor protections provided by the securities laws and regulations would benefit the customer.

Should the Agencies determine, however, to retain limitations on the types of referral fees that can be paid in this context, we suggest that the Agencies revise the Proposed Rule to permit the payment of a referral fee based on a percentage of revenue generated by the securities transactions effected by the broker-dealer for the high net worth or institutional customer. This could be accomplished by deleting the limitations contained in clauses (i)(A) - (C) and deleting the words "for investment banking services provided to the customer" in clause (ii).

If the Agencies decide, however, that the changes we propose above are not acceptable, we note that Proposed Rule 701(d)(4)(i)(C) defines a referral fee as a fee for the referral of a customer to a broker or dealer that is either "a predetermined dollar amount, or a dollar amount determined in accordance with a predetermined formula … that does not vary based on … the number of customer referrals made". In the Release, the Agencies state that a bank is permitted to pay its employee a "permissible referral fee for each referral made under this exemption" (emphasis added).[17] We assume that the Agencies did not intend to prohibit a bank from paying its employee a referral fee for each referral of a high net worth or institutional customer but we are concerned that the Proposed Rule's language is ambiguous in this regard. We therefore request that, at a minimum, the Agencies delete Proposed Rule 701(d)(4)(i)(C) in order to clarify that a referral fee may be paid for each referral of high net worth or institutional customer.

[17] 71 Fed. Reg. at 77,527-8.

5. Good Faith Safe Harbor (Proposed Rule 701(a)(2)(iv))

The Clearing House appreciates the safe harbor the Agencies have provided under Proposed Rule 701(a)(2)(iv) for a bank that acts in good faith and has in place reasonable compliance policies and procedures, and strongly supports its inclusion in the final rules. We believe, however, that the safe harbor is not sufficient to deal with the concerns we discuss above. Even if the Agencies accept all of our proposed changes, however, we urge that they retain the safe harbor.

II. Trust and Fiduciary Activities Exception

A. Definition of Trust and Fiduciary Activities

We note the language in footnote 65 of the Release indicating that the definition of "fiduciary capacity" in the GLBA was derived from Part 9 of the regulations of the Office of the Comptroller of the Currency (the "OCC"). We appreciate what we take as the implicit indication that the Agencies accept that the OCC regulations and interpretations should be the guide for determining whether an activity is a fiduciary activity for purposes of Section 3(a)(4)(B)(iii). Nevertheless, although it is certainly correct, as the Release states, that this definition was derived from Part 9 as "in effect at the time of the enactment of the GLB Act," we would not agree if this language was intended to suggest a restriction on the meaning of the term "fiduciary activities". Congress clearly did not intend to freeze bank fiduciary activities to only those activities that banks were engaged in at the time the GLBA was enacted and we would strongly reject any such possible interpretation.

B. "Chiefly Compensated" Calculation

The Clearing House banks continue to believe that requiring banks to comply with the statutory "chiefly compensated" test on an account-by-account basis is inconsistent with the language and legislative history of the GLBA. Nevertheless, we are prepared to accept one or more exemptive rules if that rule or rules adequately addresses bank concerns.

We commend the Agencies for determining in Proposed Rule 721 that relationship compensation includes both fees paid by an investment company pursuant to a plan under the Commission's Rule 12b-1 and fees paid by an investment company for personal service of the maintenance of shareholder accounts. We believe that this interpretation is consistent with the language of the GLBA and with the intent of Congress in adopting the GLBA. It is critical to banks being able to comply with the chiefly compensated test.

We do, however, have concerns with the Proposed Rules implementing the chiefly compensated test and have set them forth below.

1. Relationship Compensation: Administration Fee (Proposed Rule 721(a)(4))

The Clearing House is concerned that the definition of relationship compensation under Proposed Rule 721(a)(4) may be misinterpreted to exclude the receipt of fees from a source other than an investment company or fund. We believe that the language in Proposed Rule 721(a)(4) should be revised to be more consistent with the language in the Release to the effect that "an administration fee, annual fee or AUM fee attributable to a trust or fiduciary account is considered relationship compensation regardless of what entity or person pays the fee" (emphasis added).[18] We respectfully suggest that Proposed Rule 721(a)(4) be revised to read as follows: "Relationship compensation means any compensation a bank receives from any source that consists of:" (emphasis added).

2. Fees Received in Connection with Transactions in Certain Instruments

Section 3(a)(4)(B)(ii) of the Exchange Act provides an exception from the definition of "broker" for a bank that effects transactions in a trustee or fiduciary capacity, so long as certain conditions are met. A bank seeking to rely on this exception

[18] Id. at 77,529.

must be "chiefly compensated" for providing trust or fiduciary services by certain specified types of compensation.

Proposed Rule 721(a)(4) defines "relationship compensation" to include all the fees enumerated under Section 3(a)(4)(B)(ii) of the Exchange Act. The Clearing House believes that fees received in connection with transactions in instruments referred to in Section 3(a)(4)(B)(iii), (ix) or (x) should also be deemed to be "relationship compensation". As we noted above, a bank may effect transactions in these types of instruments without being subject to the Exchange Act's broker registration requirement because these activities are traditional banking activities. Although we acknowledge that these revenues could in some cases be categorized as commissions, because a bank may effect transactions in these instruments for the bank's trust or fiduciary accounts without registering as a broker, the bank should be able to receive fees for effecting such transactions without qualitative or quantitative limitations. There is no indication that Congress intended to limit a bank's conduct of transactions in such instruments. Therefore, we believe that a bank's revenues from transactions in these instruments should be treated as relationship compensation.

3. *Revenues from Securities Lending Activities (in a fiduciary capacity)*

Under Section 3(a)(4)(B)(viii)(I)(cc) banks are excepted from the definition of broker when they effect securities lending transactions and reinvest cash collateral as part of their safekeeping and custody activities. Proposed Rule 772 provides banks with a separate exemption from broker registration requirements when effecting securities lending transactions in a non-custodial capacity, provided that certain conditions are met. As part of the services that banks provide to their trust and fiduciary clients, banks frequently provide securities lending services. Bank are compensated for securities lending services in a variety of ways, including through fees charged directly to the account, but one common way is by agreeing with the customer to split the earnings on the reinvestment by the bank of cash collateral posted by borrowers in the

securities lending transactions banks arrange on behalf of their fiduciary clients. We believe that revenues derived from earnings on cash collateral should be treated as relationship compensation for purposes of the chiefly compensated test. Such revenues are derived from assets managed by the bank. We therefore believe that these revenues should be treated either as administrative fees or the equivalent of assets under management fees. We request that the Agencies confirm that such revenues constitute relationship compensation.

4. Fees from Regulation S Transactions

The Clearing House shares the concern expressed by the Institute of International Bankers in the IIB Letter that there is a potential conflict between the application of the exemption provided in Proposed Rule 771 (the "Regulation S Exemption") and the way in which the Agencies have interpreted the chiefly compensated test.[19] Subjecting revenues from such transactions to the limitation of the chiefly compensated test would be inconsistent with establishing the Regulation S Exemption in the first place, particularly in view of the broad definition of fiduciary capacity under Section 3(a)(4)(D).[20] On the other hand, we realize that, unlike the types of transactions described in subparts 2 and 3 of this part B, transactions in Regulation S securities do not benefit from a statutory exception. For that reason, it would not be appropriate to treat revenues from such transactions as relationship compensation. We therefore request that the Agencies provide that revenues from transactions conducted in reliance on the Regulation S Exemption simply be excluded from a bank's calculation of its compliance with the chiefly compensated test. We do not believe that treating such revenues as being subject to the chiefly compensated test is what the Agencies intend, nor do we believe that it would be in the best interests of customers.

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[19] See pp. 5-7 of the IIB Letter.

[20] Of course, we understand that if a bank conducts transactions in reliance on the trust and fiduciary exception, the bank would have to meet all of the conditions to that exception.

5. Performance-Based Fees

We believe that other performance-based fees (not related to securities lending activities) should also be treated as relationship compensation. These fees are derived from a measure of the growth of assets under management at the bank, and thus should be deemed to be either a fee based on a percentage of assets under management or as an administration fee. They are not transaction-based, and thus there is no reason why they should be treated unfavorably under the chiefly compensated test.

6. Settlement Fees

We also believe that when a bank that is acting in a fiduciary capacity is involved in the settlement but not the execution of a securities transaction, the fee it charges for handling settlement should not be limited to the bank's cost in order to be treated as relationship compensation. Under the statute, the requirement that processing fees be limited to a bank's cost is applicable only when the bank is involved in executing the transaction.

C. Trust and Fiduciary Compensation on a Bank-Wide Basis (Proposed Rule 722)

1. Application of Calculation

The Clearing House believes that the bank-wide exemption available under Proposed Rule 722 needs to be revised to provide banks with greater flexibility. Therefore, we urge the Agencies to revise this exemption as stated below.

We believe that banks relying on the trust and fiduciary exception should not be required to calculate trust and fiduciary compensation under the same formula across all of the bank's business or geographic units. More specifically, we believe that a bank should be able to calculate trust and fiduciary compensation on an account-by-account basis for one or more business or geographic units, and still be eligible to use the bank-wide exemption calculation for trust and fiduciary compensation received by the rest of the bank.

We urge the Agencies to take into consideration the global markets in which many banks operate and the differences in business models among banks across the country. For instance, a large bank with a small trust department or division in a certain region of the country may wish to calculate trust and fiduciary revenue for this department or division on an account-by-account basis because it is administratively easier and less costly. Similarly, different business or geographic unit of a bank, operating under different managements and/or using different management reporting systems, may reach different conclusions about which method is simpler to employ administratively given the scope and nature of their businesses. Moreover, some financial holding companies engage in trust and fiduciary activities in the same banking entity through more than one major, separately managed business line. We see no reason why banks that make the decision to use the account-by-account test for one or more of their business or geographic units should have to forgo the exemption under Proposed Rule 722 for calculation of its trust and fiduciary compensation received from the rest of the bank.

Permitting banks to calculate their compliance with the terms of the exception in the manner stated above may be administratively simpler for many banks and we believe the Agencies' goal of permitting banks to continue to perform traditional banking activities will be served. Therefore, we respectfully request that the Agencies permit banks to determine how to meet this test in the most efficient manner, which will ultimately inure to the benefit of customers at no cost to the regulatory protections provided by the conditions of the Proposed Rule.

2. Relationship Compensation Percentage

The Clearing House is concerned that Proposed Rule 722's reference to calculating the ratio of relationship to total compensation for "a bank's trust and fiduciary business" may be misinterpreted. We believe that the correct measure should be the ratio of relationship to total compensation attributable to trust and fiduciary accounts. The distinction is an important one, because there is no definition of a "trust and fiduciary

business", there is only a definition of a trust or fiduciary account. Banks organize themselves in a variety of ways, and they should not be required to include in the denominator of this ratio revenues that may for extraneous reasons be earned in a trust or fiduciary division or "business" unless those revenues are in respect of a trust or fiduciary account. Accordingly, we urge the Agencies to revise the language in the Proposed Rule where it refers to a bank's trust and fiduciary business to refer to a bank's trust and fiduciary accounts.

3. Foreign Branches of U.S. Banks

A foreign branch of a U.S. bank effecting transactions for non-U.S. persons is not required to register as a broker under the Exchange Act as a result of such activities. Because foreign branch activities involving non-U.S. persons would not require the foreign branch or the bank to register as a broker, we believe that a bank should be permitted to exclude revenues earned on trust and fiduciary accounts held in its foreign branches when determining whether it meets the "chiefly compensated" condition in the trust and fiduciary exception.

Customers generally would not expect to enjoy the protections of the U.S. securities laws when dealing with a branch of a U.S. bank outside of the United States. We believe that the majority of foreign branches' business is conducted with non-U.S. persons, and in order to remain competitive with non-U.S. banks in foreign markets, such branches need to be able to continue to offer the products and services they have historically offered. Including revenues from a foreign branch's dealings with non-U.S. persons in the chiefly compensated calculation would be an inappropriate burden on those branches, which operate in different markets and currencies, and have different infrastructures. We do not believe doing so would serve any U.S. public policy purpose. At the same time, the administrative burden of determining which trust and fiduciary account-related revenues of a foreign branch are from U.S. persons and which are from non-U.S. persons would be significant. Therefore, The Clearing House respectfully

requests that the revenues earned in relation to trust and fiduciary accounts held in foreign branches of U.S. banks be exempted from the "chiefly compensated" test.

III. Exemption for De Minimis Accounts (Proposed Rule 723)

Among the conditions for relying on the de minimis exclusion provided in Proposed Rule 723(d)(2) for determining compliance with the chiefly compensated test is a cap on the number of trust and fiduciary accounts excluded from the computation by the bank. We appreciate the Agencies' recognition that a de minimis exclusion is appropriate, and we expect that it will significantly reduce the compliance burden of banks as they seek to ensure that they comply with the limitations of the chiefly compensated test. We believe, however, that the threshold unfairly discriminates against large banks by imposing an absolute limit of 500, and we suggest revising the test to be either the greater of 1% or 500, or alternatively deleting the cap of 500 accounts.

IV. Sweep Accounts Exception (Proposed Rule 740)

The Clearing House commends the Agencies for moving away from Proposed Regulation B's interpretation of the term "program" under Section 3(a)(4)(B)(v) of the Exchange Act. We particularly wish to commend the Agencies for their recognition that Congress did not intend for the term "program" to limit the availability of the statutory sweep exception.

Congress adopted the statutory sweep exception in Section 3(a)(4)(B)(v) of the Exchange Act to allow banks to sweep funds from bank deposit accounts into "no-load" money market funds. Under Proposed Rule 740(c)(1), a mutual fund will satisfy this "no-load" requirement only if its charges for sales or sales promotion expense, personal service or the maintenance of shareholder accounts do not exceed 25 basis points of average net assets. We reiterate our belief that Congress did not intend to import the NASD restriction on advertising a fund as "no-load" into the statutory sweep exception. We believe that interpreting the GLBA as requiring banks to change their current practices with respect to sweep accounts goes against Congress' intent.

Nevertheless, we are pleased that the Agencies addressed this issue by adopting the exemption under Proposed Rule 741. We believe that with one change this exemption, as discussed below, will be sufficient to deal with our concerns.

V. Exemption for Transactions in Money Market Funds (Proposed Rule 741)

Proposed Rule 741 provides an exemption for banks from the definition of broker for effecting customer transactions in money market funds. This Proposed Rule is particularly important to The Clearing House member banks because, although its coverage is broader, one aspect of the Proposed Rule restores what we believe to be the statutorily granted exception permitting banks to sweep customer funds into all money market funds that do not charge a front end or back end load.

One condition of the Proposed Rule is that a bank delivers a prospectus for the securities of a money market fund that does not qualify as “no load” under the NASD’s definition of that term “not later than at the time the customer authorizes the bank to effect the transactions”. We appreciate the Agencies’ acknowledgement, through the Proposed Rule, of banks’ traditional role in effecting customer transactions in money market funds. We do not, however, see a reason why the prospectus delivery requirements applicable to bank sales of securities of these money market funds, particularly in connection with sweep arrangements, should be any different from the prospectus delivery requirements for sweeps into, or sales of, other types of money market funds or indeed for sales of these types of money market funds by registered broker-dealers. Prospectus delivery requirements are normally dealt with under the Securities Act, and we do not believe that the Agencies have made a compelling case to deviate from the normal approach under the Securities Act. The deviation will, however, create a burden for banks, which will have to create special procedures for sales of these securities, and for customers, which will be subject to a special delay in the timing of their purchase of these types of securities from banks. We therefore urge the Agencies to delete Proposed Rule 741(a)(ii)(A).

VI. Safekeeping and Custody Activities

A. Safekeeping and Custody Exception: Exemption for Order-Taking Activities

The Clearing House continues to believe that Section 3(a)(4)(B)(viii) of the Exchange Act allows banks, as part of their custody and safekeeping business, to take orders for the purchase and sale of securities. Therefore, we reiterate our belief that a rule providing for an exemption from order-taking activities by banks should not be necessary. Nevertheless, our specific comments on the Proposed Rules under Section 3(a)(4)(B)(viii) follow.

1. Employee Compensation (Proposed Rule 760(c))

A bank may rely on the exemption for order-taking activities provided in Proposed Rule 760 only if no bank employee receives compensation from any person that is based on whether a securities transaction is executed for the accounts identified in the Proposed Rule or that is based on the securities purchased or sold by the account. We are concerned that the language in Proposed Rule 760(c) may be interpreted as prohibiting a bank from paying bonus compensation to the bank employee based on the total revenues from the account, given that a part of the revenue may have been derived from processing transactions in securities, and we request that the Agencies clarify that this is not the correct interpretation of the Proposed Rule.

2. Non-Fiduciary Administrators and Recordkeepers (Proposed Rule 760(e))

The Release indicates that Proposed Rule 760(e)(2) prohibits non-fiduciary administrators and recordkeepers from executing cross trades because doing so involves setting prices for securities transactions.[21] We strongly disagree, and believe that this condition should be eliminated. We would not, however, object to a condition

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[21] 71 Fed. Reg. at 77,532.

that any such cross trades comply with the conditions in Section 3(a)(4)(C)(ii) of the Exchange Act. Such a condition should eliminate any concerns about cross trades.

3. Definition of "Employee benefit plan account" and Related Issues (Proposed Rule 760(g))

The Clearing House appreciates the Agencies' consideration of the particular needs and unique characteristics of employee benefit plans and individual retirement accounts, and is generally very pleased with the Agencies' treatment of these types of bank customers. Although the list of illustrative plans in the definition of "Employee benefit plan account" in Proposed Rule 760(g)(3) is not exclusive, we believe the definition would provide additional legal certainty if it were changed to provide explicitly that foreign plans are also included in the definition. Non-U.S.-based employee benefit plans are customers of U.S. banks and frequently invest in the United States, and we believe that the Agencies intend that such plans are included in the scope of this Proposed Rule. Therefore, we suggest revising the definition to include the words "whether established within or outside of the United States" before the words "including, without limitation".

We also agree with the comment in the ABA/ABASA Letter that an exemption parallel to that for employee benefit plan account and IRA accounts should be included for order taking in connection with a bank that provides custody services on an "outsourcing" basis to another bank's trust or fiduciary department.

B. Carrying Broker Activities

One of the conditions to the safekeeping and custody exception provided in Section 3(a)(4)(B)(viii) of the Exchange Act, and one of the conditions to the order taking exemption in Proposed Rule 760,[22] is that the bank may not, "in connection with [safekeeping and custody] activities" act in the United States as a "carrying broker" as that term is defined for purposes of Section 15(c)(3) of the Exchange Act (other than in

[22] Proposed Rule 760(d)(3).

respect of government securities). Regulation R and the Release do not define the term "carrying broker", but in the release issued by the Commission in 2001 in connection with the Interim Final Rules[23] as well as the release issued by the Commission in connection with Proposed Regulation B,[24] the Commission discussed the matter and gave examples of activities that might, in the Commission's view, cause a bank to be considered a carrying broker. Although we believe that these statements should be deemed to be superseded as a result of Section 101(a)(3) of the Financial Services Regulatory Relief Act of 2006, we are nevertheless concerned that the discussion in these two prior releases has created uncertainty regarding the permissibility of certain traditional banking products and services. As discussed below, we therefore urge that the Agencies act jointly to clarify that conducting these traditional activities will not cause a bank to be deemed a "carrying broker".

This is a matter of real concern to The Clearing House member banks, and needs to be resolved prior to the effectiveness of Regulation R so that banks will not be subject to legal uncertainty regarding the permissibility of certain traditional bank custody and safekeeping activities.

In the release accompanying the Interim Final Rules the Commission stated that "[a] carrying broker relationship is distinguished from a permissible custody relationship by the fact that the bank is selected and its systems are utilized primarily by the broker-dealer rather than primarily by the customer".[25] The release further indicated that if a broker-dealer arranges for a majority of its customers to use custody or deposit services of a bank, "a carrying broker relationship may be established", particularly "if

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[23] 66 Fed. Reg. 27,760.

[24] 69 Fed. Reg. at 39,711-13.

[25] See footnote 174, 66 Fed. Reg. at 27,780.

the bank performs clearance and settlement functions that the broker-dealer cannot perform economically or efficiently."[26]

The discussion in the 2001 release led banks to be concerned regarding how the prohibition on being a "carrying broker" would affect a bank that provides custody and safekeeping services to its customers. In the release accompanying Proposed Regulation B the Commission again addressed this issue, repeating the statements referred to above and expanded thereon. The Commission asserted that when a bank "performs the back office functions of a broker-dealer, the bank is often acting as a carrying broker."[27] It added that a bank "may be acting as a carrying broker if it also executes customers' securities transactions through a broker-dealer whose primary purpose is to support the bank, and whose back office functions reside in the bank."[28] Later in the release the Commission asserted that another indication that a bank may be a carrying broker would include if the bank uses an affiliated broker-dealer the main purpose of which is to execute the securities transactions of the bank and the bank "assumes other functions, such as clearing transactions with a clearing agency, that properly belong within a broker-dealer" (emphasis added).[29]

Finally, the Commission identified eight factors it said it would consider in making a determination whether a bank custodian is a carrying broker:

- A bank having opening, approving and monitoring control over the broker-dealer's customer accounts.
- A bank extending credit to the broker-dealer's customers.

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[26] Id.

[27] 69 Fed. Reg. at 39,712.

[28] Id.

[29] Id. We note that many banks that engage in the custody business maintain their own accounts at major securities clearing agencies around the world, including The Depository Trust Company, Euroclear and Clearstream, just as broker-dealers do. We do not believe the Agencies intended the maintenance of an account in a clearing system to be indicative of a bank engaging in an impermissible "carrying broker" activity.

- A bank maintaining the broker-dealer's books and records.
- A bank receiving and delivering the broker-dealer's funds and securities.
- A bank safeguarding the funds and securities of the broker-dealer's customers.
- A bank preparing and issuing the broker-dealer's confirmations and statements.
- A bank accepting the customer's orders.
- A bank arranging for the execution of the customer's transactions.[30]

Most of the eight factors the Commission identified in the release accompanying Proposed Regulation B are common activities for both bank custodians and broker-dealers. Financial holding companies attempt to combine the offering of banking, securities and other related products to their customers in as seamless and convenient a way as possible. Thus, for anti-money laundering and other risk management purposes, banks and broker-dealers frequently coordinate their account opening and monitoring processes. Extending credit is a normal banking activity, and thus banks frequently extend credit to customers of their affiliated broker-dealers.[31] Affiliate banks and broker-dealers seek to streamline their back office processes, combining and/or coordinating as many functions as possible, with the result that broker-dealers and banks may rely on some of the same systems and operational processes for generating their books and records.[32] Not surprisingly, broker-dealers that are affiliated with banks may maintain funds at that bank (to the extent permissible under applicable regulations and SRO rules). Finally, it has been a common practice of banks and broker-dealers to provide their customers with the convenience of combined statements, showing the assets the customer has at the bank and the assets he or she has at the affiliated broker-dealer in a convenient single document.[33] Of necessity banks are involved in

[30] Id. at 39,713.

[31] Of course, broker-dealers and banks need to comply with the applicable margin regulations of the Board (Regulation T for broker-dealers and Regulation U for banks) and, in the case of broker-dealers, the relevant SRO margin rules.

[32] We understand that each bank and broker-dealer must comply with all applicable laws and rules concerning books and records, regardless of which system generates the books and records.

[33] Customers find these combined statements to be convenient and helpful. Combined statements are often provided in addition to confirmations and statements that a broker-dealer is required to

preparing these statements and may take the lead in preparing them and transmitting them to customers.

Simply put, many customers wish to obtain custody and related services from both banks and broker-dealers, depending on their own business preferences and, in some cases, regulatory needs.[34] Both broker-dealers and banks have historically provided custody and related services for customers' securities positions for many years.

For all these reasons, we believe that it is entirely consistent with the GLBA that banks and broker-dealers would share common customers and that they would coordinate their operations both from a front and back office perspective. We believe there is nothing wrong with banks and their broker-dealer affiliates seeking to achieve the efficiencies that come from operating on as close to a common platform as possible. We would strongly disagree with any suggestion that banks and broker-dealers are required to keep their businesses and related operations "walled off" from each other, either in terms of how they interact with customers or in terms of operational, technological or other platforms. Thus, we do not believe that when Congress included the restriction on being a carrying broker as part of the custody and safekeeping exception, it intended to prevent financial holding companies from providing products and services to their customers in a seamless manner, or attempting to achieve synergies and efficiencies from the affiliation of banks and broker-dealers. A central purpose of the

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provide under applicable Commission and SRO rules, or that a bank is required to provide under the laws and regulations applicable to it.

[34] For example, it is not uncommon for a registered investment company that principally invests in equities to maintain principal custody of its assets at a bank as required by the Investment Company Act, but open an account at a broker-dealer for the purpose of engaging in short sales and obtaining related margin financing. Similarly, many pension funds and similar institutional investors that have historically engaged in "buy and hold" strategies have tended to prefer to use the custodial services of banks, but have also begun to use accounts at broker-dealers for short selling and similar activities that banks are not able to perform. The key thing is that some customers prefer to have accounts for custody of their securities with both banks and broker-dealers.

GLBA was to allow banks and broker-dealers to affiliate and, through affiliation, to serve customers better.[35]

The eight factors identified by the Commission for purposes of determining whether a bank is acting as a carrying broker appear to have been derived from New York Stock Exchange Rule 382,[36] which the Commission cited in support of its analysis in the release accompanying Proposed Regulation B.[37] The purpose of that rule was to "clarify the responsibilities of organizations relative to the handling of customer accounts that are introduced by one organization (introducer) to another (carrier) pursuant to an arrangement known as a fully disclosed carrying agreement."[38] These factors may be very appropriate for a list of what responsibilities need to be clearly defined between an introducing and a clearing broker-dealer, but we do not believe that they define in any way what a carrying broker is for purposes of Section 3(a)(4)(B)(viii)(II).

We therefore urge the Agencies jointly to clarify that the above described banking activities, and other traditional banking activities, will not cause a bank custodian to be deemed to be a carrying broker. We believe that the essence of a carrying broker relationship is the complete dependence of a broker-dealer on another broker-dealer for not only back office functions but also execution functions. In such arrangements, a customer cannot do business with the first broker-dealer without having

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35 To the extent that the Agencies are concerned that customers may not understand the differences in legal protections applicable to their assets depending upon whether they are held in custody at a bank or a broker-dealer, such as the nature and scope of Securities Investor Protection Corporation ("SIPC") protection for assets at a broker-dealer that is a member of SIPC and the nature and scope of Federal Deposit Insurance Corporation ("FDIC") protection for funds deposited with a bank custodian, we submit that this concern can be addressed by requiring each of the bank and the broker-dealer to make the relevant disclosures regarding the nature and scope of these respective protective schemes to customers.

36 NYSE Rule 382.

37 See footnote 289, 69 Fed. Reg. at 39,712 (discussing the requirements set forth in NYSE Rule 382).

38 Release 34-18229, 46 Fed. Reg. 55,467 (Nov. 2, 1981).

an account at the second, carrying broker-dealer, either individually (in a fully disclosed clearing relationship) or through an omnibus account for all the first broker-dealers' customers. The arrangement goes beyond merely achieving operational efficiencies of the sort that banks and their affiliated broker-dealers have tried to achieve, and generally involve the second broker-dealer providing margin financing, capital and execution services, resulting in a complete dependence of the first broker-dealer on the second in all aspects of its business except accepting orders from customers. We urge the Agencies to adopt this interpretation.[39]

C. Definition of "Employee benefit plan account" (Proposed Rule 760(g))

The Clearing House appreciates the Agencies' consideration of the particular needs and unique characteristics of employee benefit plans and individual retirement accounts, and is generally very pleased with the Agencies' treatment of these types of bank customers. Although the list of illustrative plans in the definition of "Employee benefit plan account" in Proposed Rule 760(g)(3) is not exclusive, we believe the definition would provide additional legal certainty if it were changed to clarify that foreign plans are also included in the definition. Non-U.S.-based employee benefit plans are customers of U.S. banks and frequently invest in the United States, and we believe that the Agencies intend that such plans are included in the scope of this Proposed Rule. Therefore, we suggest clarifying the definition to include the words "whether established within or outside of the United States" before the words "including, without limitation".

VII. Exemption for Transactions in Securities Issued Pursuant to Regulation S (Proposed Rule 771)

The Clearing House supports the Regulation S exemptions contained in the Agencies' Proposed Rule 771 and in the Commission's Proposed Rule 3a5-2.

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[39] We also note that the Commission recently proposed amendments to Rule 15c3 that would, among other things, limit a broker-dealer's ability to maintain its "Special Reserve Bank Account for the Exclusive Benefit of Customers" under that rule with an affiliated bank. See Release No. 34-55431, 72 Fed. Reg. 12,862, 12,864 (March 19, 2007). We are concerned about such a rule and are in the process of reviewing the entire rule. We urge the Commission to consult with the Board and the other federal banking agencies before adopting any such rule.

Although we understand that exemptions were originally suggested by a trade association for non-U.S. banking organizations, we believe that they will be important to U.S. domestic banking organizations in their dealings with non-U.S. clients and will be critical to enabling U.S. banks to remain competitive with non-U.S. banking organizations. Although we appreciate these two Proposed Rules, we believe that changes are necessary to ensure that banks will actually be able to rely upon them. We believe that these changes can be made without any danger to investor protection.

First, we note that Proposed Rules 771(a)(2) and 3a5-2(a)(2) both contain a "reasonable belief" standard, under which a bank may rely on its reasonable belief that particular securities were originally offered and sold in compliance with Regulation S, while Proposed Rules 771(a)(3) and 3a5-2(a)(3) do not. We believe that a reasonable belief standard is appropriate, because it may not be possible for a bank to know whether securities were originally sold in compliance with Regulation S. We therefore believe that the reasonable belief standard should be added to Proposed Rules 771(a)(3) and 3a5-2(a)(3).

Second, we are concerned that language in the Proposed Dealer Rules release may (we presume unintentionally) call into question whether Proposed Rule 3a5-2 is available when a bank undertakes secondary market riskless principal transactions in "seasoned" Regulation S securities. The Proposed Dealer Rules release contains the statement: "After the requirements of Regulation S cease to apply to an issuance, a bank could resell such a [Regulation S] security to another non-U.S. person or a broker-dealer, as long as the transaction complies with another bank broker or dealer exception or exemption."[40] This statement seems to contradict the Proposed Rule itself by suggesting that Proposed Rule 771 is not available after Regulation S "ceases to apply to the issuance". We can see no purpose in the Agencies jointly (or the Commission separately) exempting banks from the requirement to register as a broker or a dealer in connection with primary offerings of Regulation S securities but not to do so in connection with

[40] 71 Fed. Reg. at 77,551.

secondary market trading of such securities. We therefore request that the Commission clarify the above-quoted language and confirm that it was not intended to suggest such a limitation on the scope of the Proposed Rules.

Third, we believe the language in Proposed Rule 771(a)(2) and (3) and Proposed Rule 3a5-2(a)(1) and (3) that restricts resales of Regulation S securities to a "purchaser who is outside the United States within the meaning of 17 CFR 230.903" or, in the case of Proposed Rule 771(a)(2) and (3) and Proposed Rule 3a5-2(a)(1) to a registered broker or dealer, is unnecessarily restrictive. A "purchaser" is already defined as a person "who is not a U.S. person under 17 CFR 230.902(k)". We believe that the restriction in the definition of purchaser should be sufficient.

Fourth, we believe that Proposed Rule 3a5-2 should be made consistent with Proposed Rule 771(a)(2) (as we have suggested that Proposed Rule 771(a)(2) should be amended) by permitting resales as riskless principal to non-U.S. persons and to broker-dealers in the same manner that Proposed Rule 771(a)(2) would allow agency resales.

Fifth, we believe that the provisos in Proposed Rules 771(a)(2) and (3), and in Proposed Rule 3a5-2(a)(1) that require compliance with Regulation S itself are unnecessary, given that they appear only to require that, if applicable, Regulation S itself be complied with. If, however, these provisos are retained, we believe that the final words thereof should be amended to read "the requirements of 17 CFR 230.903 or 230.904, as applicable".

VIII. Exemption for Transactions in Investment Company Securities (Proposed Rule 775)

Section 3(a)(4)(C) of the Exchange Act requires that banks relying upon the trust and fiduciary activities, stock purchase plan and safekeeping and custody exceptions adopted by the GLBA effect trades pursuant to those exceptions in "any security that is a publicly traded security in the United States" through a registered

broker-dealer (unless one of certain exceptions applies). The statutory requirement to execute through a broker-dealer thus applies only to securities that are "publicly traded" in the United States.

The Clearing House continues to believe that shares of open-end investment companies ("mutual funds"), other than exchange listed ETFs, are not traded publicly or otherwise. Mutual fund shares are not listed on securities exchanges, nor do any broker-dealers make markets in them. Investor purchases of a mutual fund's shares are satisfied by the issuance of new shares by the fund. Shares are not ordinarily sold by investors, but instead are redeemed by the fund. Therefore, we reiterate our belief that Proposed Rule 775 should not be necessary because mutual fund securities are not publicly traded in the United States.

The same analysis applies to interests in variable annuity policies issued by insurance companies. Such policies are not publicly traded, but are purchased directly from the insurance company or through the services of the National Securities Clearing Corporation. We therefore request that the Agencies either clarify that variable annuity policies would not be deemed to be publicly traded in the United States or expand Proposed Rule 775 to cover transactions therein.

IX. Exemption for Securities Repurchase and Reverse Repurchase Transactions

Proposed Rule 772 provides an exemption from the definition of "broker" for a bank engaging in securities lending transactions as an agent. Securities repurchase and reverse repurchase transactions are economically equivalent to securities lending transactions.[41] In both cases, a security is transferred from one party to another and collateral is posted to secure the obligations of the counterparty to perform its future obligations. In our view, the only real difference between securities repurchase and

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[41] Of course, banks currently are permitted to engage in repurchase and reverse repurchase transactions with respect to "exempted securities" (as defined in Section 3(a)(12) of the Exchange Act) without having to register as a broker or dealer under the Exchange Act.

reverse repurchase transactions, on the one hand, and securities lending transactions, on the other, is the characterization and documentation of the transactions.

Because the economic substance of a securities repurchase or reverse repurchase transaction is equivalent to that of a loan of securities secured by cash collateral, we believe that a bank in effecting securities repurchase and reverse repurchase transactions as agent is the functional equivalent of a bank acting as an agent in effecting securities lending transactions. We believe the same rationale that led the Agencies to provide an exemption for banks acting as agent in securities lending transactions supports an exemption for banks acting as agent in securities repurchase and reverse purchase transactions in non-exempt securities. Therefore, we respectfully request that the Agencies provide exemptive relief for banks, as agent, entering into securities repurchase and reverse repurchase transactions involving non-exempt securities paralleling the exemption in Proposed Rule 772.

In the Proposed Dealer Rules release, the Commission has proposed to amend Rule 15a-11, which contains an exemption from the definition of "dealer" in Section 3(a)(5) of the Exchange Act for bank conduit securities lending activities. As a corollary to our request above, we request that the Commission adopt an exemption for banks from the definition of "dealer" to the extent that they engage in repurchase and reverse repurchase transactions with respect to non-exempt securities. As noted, repurchase and reverse repurchase transactions are the economic equivalent of securities lending transactions, which the Commission has already decided banks may conduct without registering as a dealer. We note that providing financing and liquidity to customers via repurchase and reverse repurchase transactions is a traditional banking activity, and permitting banks to engage in such transactions with respect to non-exempt securities will benefit customers that do not have exempt securities against which to borrow.

X. Dual Employees

We continue to believe it is critical that the concerns we have previously raised regarding NASD Rule 3040 be addressed promptly, and, in any event, no later than before the promulgation of a final version of Regulation R. This is an issue for "dual hatted" bank employees today, and could become an even greater issue after the expiration of the blanket exemption for banks from the definition of broker. NASD Rule 3040 should not be interpreted in such a way that bank-affiliated broker-dealers have to become involved in overseeing, and keeping records regarding, the banking activities of licensed personnel of broker-dealers, or that the NASD becomes involved in overseeing such banking activities.

The Clearing House believes that such an interpretation of NASD Rule 3040 would contradict the theory of functional regulation that is fundamental to the GLBA, i.e., that banking activities should be regulated by the banking regulators. It would also require unnecessary duplication of supervision and record-keeping between banks and broker-dealers because broker-dealers would be required to approve and keep records of transactions that are properly processed by bank systems. Of particular concern are dual employee arrangements involving bank fiduciary employees, where the effect of NASD Rule 3040, among other things, would be to require that transactions be recorded on incompatible systems (the broker-dealer's system and the bank's trust system).

The Clearing House strongly believes that the issues set forth above should be resolved prior to the effective date of final rules implementing Title II of the GLBA. We respectfully request that the Agencies work together with the NASD in obtaining an amendment to NASD Rule 3040. The amendment should (a) allow a securities firm to give blanket consent to its employees to be dual employees with the

bank[42] and (b) provide that bank activities need only be supervised by managers in the bank, subject to the broker-dealer's being informed if the employee engages in securities fraud in the bank.

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The Clearing House would be pleased to discuss any of our comments in more detail. If you have any questions, please contact Norman R. Nelson, General Counsel, at (212) 612-9205.

Sincerely yours,

[42] Such a blanket consent should also be available to satisfy the notice requirements applicable to outside business activities of registered personnel in NASD Rule 3040 to the extent that such activities are subject to the regulation of a federal banking agency.