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STATE STREET.

March 26, 2007

Nancy C. Morris
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090
rule-comments@sec.gov.

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

Re: Definitions of Terms and Exemptions Relating to the "Broker" Exceptions for Banks; File No. S7-22-06; Docket No. R-1274; 71 Federal Register 77522, December 26, 2006

Re: Exemptions for Banks Under Section 3(a)(5) of the Securities Exchange Act of 1934 and Related Rules; File No. S7-23-06; 71 Federal Register 77550, December 26, 2006

Dear Ms. Morris and Ms. Johnson:

State Street Corporation appreciates the opportunity to comment on the proposed Regulation R (the "Proposed Rule") jointly issued by the Securities and Exchange Commission and the Board of Governors of the Federal Reserve System (collectively, the "Agencies") to implement certain exceptions for banks from the definition of "broker" under Section 3(a)(4) of the Securities Exchange Act of 1934 (the "Exchange Act"), as amended by the Gramm-Leach-Bliley Act of 1999 (the "GLBA").

We appreciate the Agencies efforts in developing this proposal, and believe that Regulation R is much improved over previous similar proposals.

I. Basis of this Request -- State Street's Business Model and Client Base

State Street is a leading specialist in providing services to institutional investors, with over $11.9 trillion in assets under custody and over $1.7 trillion in assets under management as of December 31, 2006. Operating in 26 countries and in more than 100 markets worldwide, State Street offers core custodial and value-added products and services, such as fund accounting, fund administration, securities lending, investment manager operations outsourcing, record-keeping, performance and analytics, and transfer agency services. Its investment management services, offered through State Street Global Advisors (SSgA) include the design and implementation of sophisticated investment strategies and a range of separate accounts, mutual funds, collective investment funds, and exchange traded funds. In addition, State Street, through State Street Global Markets, provides research and trading services to institutional investors, including services offered by its registered broker-dealer, State Street Global Markets, LLC.

Consistent with this business model, State Street serves an almost exclusively institutional base of customers, including domestic and foreign banks and other depository institutions, mutual funds, insurance companies, investment advisers, corporate treasurers, pension plan sponsors, endowments, partnerships, state and local governments, foreign governments, and other non-retail customers. State Street is not engaged in a retail banking business.

We are members of the American Bankers Association ("ABA") and its affiliate, the ABA Securities Association ("ABASA"), and we participated in the drafting of their comment letter (the "ABASA Comment Letter"). In several areas, however, we would like to emphasize suggested changes to the Proposed Rules of particular importance to banks serving institutional customers.

The federal securities laws and the regulations adopted by the Commission to implement those laws have long recognized that institutional investors do not require the protection of all aspects of these laws and regulations and that for some categories of investors the full application of the investor protection aspects of the securities laws hinders the efficient delivery of financial services to such clients. For example, the Commission has recognized that "qualified institutional buyers" ("QIBs") do not need the same disclosure protections in public offerings that are appropriate for retail investors. Similarly, the Commission has determined that "qualified purchasers" ("QPs") do not require the protections of the Investment Company Act or the Investment Advisers Act. These exemptions have been premised both upon the effective allocation of the Commission's resources and the fact that sophisticated institutional investors have the resources, sophistication and market influence to protect themselves. Because these customers regularly transact business based on their status as QIBs or QPs, participants in the securities industry typically have access to the relevant certifications for these customers.

We believe that the institutional customers served by State Street, such as QIBs and QPs, have the resources to understand and evaluate complex issues and relationships, and to negotiate the terms of those relationships. Therefore, they do not need the extensive investor protection provided retail customers contemplated by the Proposed Rule. Rather, in an institutional marketplace, the Proposed Rule will serve to add procedural steps that do not benefit the institutional investors but which increase the cost of servicing such clients.

For these reasons, State Street requested a general exemption for institutional investors from the SEC's 2004 proposed Regulation B. While the current Proposed Rules recognize the special status of institutional customers in several areas, we recommend the Commission adopt amendments and provide interpretive clarifications that we believe will reduce administrative burdens without reducing the protective benefits for institutional investors.

II. Networking Arrangements

Proposed Rule 701 sets forth exemptions from the definition of "broker" in connection with the payment of referral fees. One such exemption allows referral fees for referring "institutional customers" to brokers under certain circumstances. Proposed Rule 701(d)(2) defines the term "institutional customer" with respect to either an investment test (a minimum of $10M, the "investment test") or an asset test (a minimum of $40M or $25M if the referral is for investment banking services, the "asset test").

While we appreciate the Agencies recognition of the different needs of banks serving institutional customers in the Proposed Rule, we believe the treatment of this type of customer can be further improved, with no loss of investor protection. As described above, current SEC rules provide several definition of institutional investor, QIBs and QPs, which we believe can be used to simplify the Networking Exception for customers that meet these definitions. In addition, we suggest the Agencies permit affiliates of institutional customers which would not themselves qualify under the term to be treated as institutional customers under certain circumstances.

a) Treatment of QIBs and QPs as "Institutional Customers"

Most of State Street's customers are either QIBs as defined in Rule 144A(a)(1) promulgated under the Securities Act of 1933 or QPs under Section 2(a)(51) of the Investment Company Act of 1940, as amended. Each of these definitions represents a well-established standard of sophisticated investor that does not require the detailed protections of certain provisions of federal securities laws. The protections from which institutional investors are exempt under the Securities Act and the 1940 Act are no less important than those sought to be protected by Regulation R. Having determined that an institutional investor does not need the protections of the Securities Act and/or the 1940 Act, the conclusion that such investor may need the protections of the Securities Exchange Act with respect to referral fees, or other investor protection of Proposed Rules, seem incongruous.

It is also important to note that the exemption in no way relates to the aspects of the Securities Exchange Act that seek to protect the transparency or effective operation of the securities markets; the objective of the referral fee provision is solely investor protection. The proliferation of different institutional standards for each of the federal securities laws also compounds the administration of the federal securities laws and the efforts of investors and service providers to comply with these requirements. Where there is not a substantial basis for adopting differing institutional standards, employing more uniform or overlapping definitions[1] would promote the efficient and effective compliance with these requirements.

State Street recommends supplementing the definition of institutional customer to include QIPs and QPs, and providing a broad exemption from the Networking Exception for such customers. Adopting these would significantly reduce the compliance burden on banks serving institutional customers, while not in any way diminishing the protection afforded by Proposed Rule 701(d)(2).

b) Inclusion of Certain Affiliates as Institutional Customers

State Street and other banks serving sophisticated institutional customers are often called upon to service the smaller affiliates of sophisticated customers, including newly formed entities without significant assets at the time of organization. For example, the entity may have an investment management agreement with an investment adviser that represents a substantial number of investment pools, some of which individually would qualify as institutional customers but other of which do not yet meet the size definitions. For investment pools, including mutual funds, investment partnerships, pension plans and other retirement vehicles, the size and sophistication of the investment manager or other service provider that will be negotiating with the bank on behalf of the entity is in many instances much more critical than the size of the entity itself. Such customers enjoy the protection provided by being part of a group which possesses substantial size and sophistication and typically, sophisticated management.

Therefore, we believe that the Proposed Rules should be revised to permit banks serving institutional customers to treat certain affiliates of institutional customers as "institutional customers" for purposes of the Proposed Rules, even if such affiliates would not qualify on a stand-alone basis. In the definition of QIBs the Commission recognized the merits of such approach by incorporating the "family of funds" concept. We believe that same approach, but applied to entities other than registered mutual funds, is similarly appropriate.

More specifically, we recommend that any customer that meets the definition of "qualified investor" under any provision of Section 3(a)(54) of the Exchange Act other than (xii) and is a member of an affiliated group under common control that in the aggregate satisfies either the investment or the asset test of Proposed Rule 701(d)(2) meet the definition of "institutional customer."

III. Trust and Fiduciary Activities Exemption

a) Evaluate Compensation on an Organization-Wide Basis

Proposed Rule 722 currently contemplates that banking organizations should calculate their relationship to total compensation ratios on a bank-wide basis. For a variety of business reasons, certain banks choose to perform trust and fiduciary functions through their affiliates. State Street believes that banks should not be penalized for making such business decisions by being forced to exclude trust and fiduciary compensation earned through affiliates from their calculation of their relationship to total compensation ratio.

[1] The definition of a QP, for example, includes a QIB.

State Street believes that the Proposed Rule 722 in its current form already allows banks to include trust and fiduciary fees earned by separately identifiable divisions ("SIDs") within a bank. In addition, State Street notes that wholly owned operating subsidiaries of banks that are registered with the SEC as investment advisors are, for most regulatory purposes, identical to SIDs and therefore there is no basis to deny such subsidiaries the same treatment as SIDs. As the Board is aware, wholly owned operating subsidiaries of banks are subject to the same permissible activity restrictions as banks are, and in fact are treated like a division of a bank for most regulatory purposes. Accordingly we suggest that the trust and fiduciary compensation received through a wholly owned operating subsidiary should also be included in a bank's calculation of its relationship to total compensation ratio.

Finally, if banks decide to perform all or part of their fiduciary operations through affiliates that are under common control, there is little to differentiate using such an operational structure from performing trust and fiduciary functions through SIDs or wholly owned operating subsidiaries. Therefore, we believe such structures should also be treated on an equal basis for purposes of the chiefly compensated test.

In sum, banking organizations may choose to locate fiduciary activities either within the bank, or in a nonbank subsidiary or affiliate, for a variety of business, legal, tax or other reasons. In each case, the nonbank entity selected by the bank for inclusion in the relationship to total compensation ratio would be performing trust or fiduciary services of the kind historically performed by banks. Indeed, for decades the bank regulators have provided banking organizations the flexibility to structure their trust and fiduciary operations in this manner. As a result, we submit that Regulation R should permit a bank to include selected nonbank affiliates as well as the bank itself when calculating its relationship to total compensation ratios.

b) <u>Fees for Custody Services for Trust and Fiduciary Clients as Relationship Compensation</u>

State Street's sophisticated institutional trust and fiduciary customers often require State Street to specify compensation for each related service on an itemized basis in its fee schedule. Proposed Rule 721 does not make clear whether fees from trust and fiduciary clients explicitly charged for custodial activities ("Fiduciary-Custodial Compensation") also qualify for treatment as "relationship compensation." State Street submits that the compensation from trust and fiduciary clients that it identifies as Fiduciary-Custodial Compensation is compensation that would clearly meet the definition of "relationship compensation" were it recorded together with other types of trust and fiduciary compensation, as is typical in many banks. If State Street is required to eliminate Fiduciary-Custodial Compensation from its "relationship compensation" measure, State Street's ability to meet the "chiefly compensated" test would be unduly hampered merely because of the sophisticated nature of its customer base.

Similarly, State Street receives transaction based compensation from institutional trust and fiduciary customers in relation to traditional custody services, including, for example, post-trade clearing and settlement of securities trades. Such fees are unrelated to the "execution" of securities trades, and are unrelated to order taking for our customers. In fact, as noted by the Agencies in the Proposed Rules, such fees are clearly exempted by statute from the definition of "broker" by the Safekeeping and

Custody Exemption. When collected in connection with services provided to trust and fiduciary customers, we believe such fees should clearly be considered "relationship compensation" for purposes of the chiefly compensated test, regardless of the costs incurred by the bank.

Therefore, State Street recommends that the definition of "relationship compensation" set forth in Proposed Rule 721 explicitly include all custody services provided to trust and fiduciary customers, as long as the custodial activities which generate the fees comply with the requirements necessary to meet the Safekeeping and Custody Exemption.

c) Certain Asset-Based Fees as Relationship Compensation

The definition of "relationship compensation" in Proposed Rule 721(a)(4)(iii) references "a fee based on a percentage of assets under management, *including, without limitation*" (emphasis added) and lists several types of fees. Institutional customers often have highly negotiated compensation arrangements for their fiduciary and trust accounts with banks and we would like to clarify the inclusion of certain fees that we believe should be permissible.

First, in an increasing number of circumstances, we find that these arrangements include performance-based fees. Generally, in a performance fee arrangement the bank is compensated based on capital gains or capital appreciation of assets which represent the investment performance of the account. In some cases, these fees are based on a benchmark return and in some cases they operate on a fulcrum basis. In all cases, these fees are not transaction based. We request that the definition of "relationship compensation" specifically include performance based fees, *i.e.* fees determined by reference to the capital gains upon or capital appreciation of assets in a fiduciary or trust account.

Second, many of our institutional customers engage State Street as a securities lending agent, which is clearly permissible under GLBA and the Proposed Rules. Typically, the compensation for these services is based on the income generated from the securities lending activity, which depends on the nature and asset value of the securities lent. Accordingly, while the compensation is derived from a percentage of assets lent, the assets may not be under the management of the applicable bank, and the compensation could be viewed as based on income rather than asset value. Nevertheless, given that the activity is clearly permissible, we believe this form of non-transactional compensation should be included within the definition of "relationship compensation." We request that the fees generated based on customers' income from securities lending activities should specifically be included within the definition of "relationship compensation."

IV. Safekeeping and Custody Exemption

a) Institutional Custody Exemption

As discussed above, State Street's customer base is composed almost entirely of highly sophisticated institutional investors. As noted above, the SEC has previously recognized that such customers require fewer protections from the securities laws than retail customers. In fact, Regulation R's predecessor, Regulation B, proposed a custody exemption for "qualified investors," as defined in Section 3(a)(54) of the Exchange Act. Many of these institutional customer accounts will fall under the Trust and Fiduciary or employee benefit exemptions. However, some institutional accounts, such as foundations and endowments, may not meet the requirements of these exemptions, and, therefore, would be subject to the restrictions for accommodation trades for order taking activity. Foundations and endowment accounts operate very similarly to employee benefit plan accounts. They are professionally managed for long-term growth, and operate under fiduciary rules similar to those required under ERISA. We believe distinguishing between employee benefit plan accounts and these types of accounts under the Proposed Rules is inappropriate, and places an unnecessary compliance burden on banks serving institutional customers.

State Street suggests the Agencies revise the Proposed Rules to provide a custody exemption for qualified investors that are not trust and fiduciary or employee benefit plans, similar to that provide employee benefit plan accounts under Section 760 of the Proposed Rules. Such a change will not negatively affect the protection of investors and will provide significant regulatory relief to banks, like State Street, that provide services to institutional clients.

b) Carrying Broker

We share the concerns stated in the ABASA Comment Letter regarding the definition of the term "carrying broker" in relation to the application of the Safekeeping and Custody exemption. Lack of clarity with regard to this definition may seriously hamper the ability of banks which serve sophisticated customers to offer innovative safekeeping and custody products and services.

V. Securities Lending Exemption

We share the concerns stated in the ABASA Comment regarding the Securities Lending Exemption. In recognition that it is not uncommon for a customer to divide custody and securities lending management between two entities, proposed Rule 772 provides an exemption for securities lending when the bank is not also performing custodial services for the customer. We would strongly encourage the Agencies to affirm explicitly in the final rule that the requirements under the exemption for securities lending activities conducted as agent do not apply to the securities lending management activities of custodians. There has been some confusion by the use of the term "agent" in proposed Rule 772 that has led uncertainty whether banks acting in a custodial capacity must also comply with the exemption in Rule 772 when conducting securities lending services for the same customer. We believe that the intention of footnote 115 of the Release was to clarify that this is not the case. However, given the importance of this matter to custody banks, we request that this intention be incorporated into Rule 772 itself in order to eliminate any further confusion.

VI. Use of Rule 12d1-1 Funds in Sweep Accounts

Proposed Rule 740(b) defines "money market fund" to mean funds that are registered under the 1940 Act and are regulated under Rule 2a-7 under that Act. The

Commission recently adopted Rule 12d1-1[2] to permit mutual funds to participate in cash sweep arrangements into a fund that complies with Rule 12d1-1 (which in turn requires that the fund operate in compliance with Rule 2a-7). A fund operated in compliance with Rule 12d1-1 need not be registered under the 1940 Act. While these funds have not yet experienced widespread use, we recommend that the definition of "money market fund" be expanded to include unregistered funds that comply with Rule 12d1-1. This change will be beneficial to banks like State Street that serve as custodian to mutual funds that may seek to take advantage of the Commission's new rule, and because of the protections of Rule 12d1-1, will not be harmful to customers.

VIII. Conclusion

We would like to reiterate our appreciation for the efforts of the Agencies and their staff in developing these Proposed Rules, which we believe are significantly improved over previous versions. We also appreciate the opportunity to comment on the issues that are of particular interest to banks serving institutional customers, such as State Street, and we welcome the opportunity to provide further information or to discuss these issues in greater detail.

Sincerely,

[2] Sec. Rel. IC-27399 (July 31, 2006).