

**U.S. SECURITIES AND EXCHANGE COMMISSION
OPEN MEETING – JUNE 2, 2004
FACT SHEET**

1. Regulation B Proposals

The Gramm-Leach-Bliley Act (GLBA) replaced banks' complete exception from the definition of "broker" with eleven "functional exceptions." The Commission today will consider proposing new rules to implement the GLBA definition by defining some of the statutory terms used in the eleven exceptions. It will also consider proposing a number of new exemptions for some particular bank activities, under conditions that are consistent with investor protections. All of these provisions build off of rules the Commission adopted in 2001 (Interim Rules).

The proposals would extend many of these provisions to savings associations and savings banks, and also exempt credit unions that engage in certain limited securities activities as long as they are conducted under the terms applicable to certain of the bank exceptions from the definitions of broker and dealer.

Networking Exception

The statutory third-party brokerage (networking) exception allows banks to partner with broker-dealers in offering their customers a wide range of financial services, including securities brokerage. Under this exception, a broker-dealer offers brokerage services to bank customers and shares the compensation with the bank. The exception also allows unregistered bank employees to receive incentive compensation in the form of a "nominal one-time cash fee of a fixed dollar amount" for referring bank customers to the broker-dealer.

The Commission will consider proposing amendments to the Interim Rules to

- clarify the scope of activities in which unregistered bank employees may engage
- define nominal compensation as:
 - the employee's base hourly rate of pay;
 - a flat \$25 dollar amount; or
 - an inflation adjusted amount based on fifteen 1999 dollars

Trustee and Fiduciary Account Exception

The trust and fiduciary activities exception permits a bank, under certain conditions, to receive "sales compensation" (e.g., commission-type compensation or sales charges and service fees paid out of mutual fund assets pursuant to a distribution plan adopted under rule 12b-1) for effecting transactions for its customers in a trustee or fiduciary capacity without registering as a broker. Under this exception, a bank must effect such transactions in its trust department, or other department that is regularly examined by bank examiners for compliance with fiduciary principles and standards.

The bank also must be “chiefly compensated” for any securities transactions, consistent with fiduciary principles and standards, on the basis of “relationship compensation” (i.e., an administration or annual fee, a percentage of assets under management, a flat or capped per order processing fee that does not exceed the cost the bank incurs in executing such securities transactions, or any combination of these fees).

The term “chiefly compensated” is not defined in the statute. The Interim Rules both defined the term to mean that relationship compensation exceeds sales compensation as determined on an account-by-account basis and provided a limited exemption to permit a bank to assess its compliance on an aggregate, rather than an account-by-account, basis using a proportion of 9 to 1 as the ratio for relationship to sales compensation as long as other procedural requirements were met. They also provided a limited exemption for banks acting as indenture trustees.

The Commission will consider proposing several amendments to the Interim Rules. These amendments are intended to simplify banks’ compliance with this statutory requirement through both definitions and targeted exceptions. These amendments would

- expand the definition of “relationship compensation,” which is a component of the comparison, to include fees generated by all types of assets
- provide additional exemptions, including
 - a small bank custody exemption that can be used by qualifying small banks in lieu of the “chiefly compensated” comparison and the other requirements of the trust and fiduciary activities exemption (Additional details regarding this exemption are provided below under the custody discussion.)
 - a new exemption from the “chiefly compensated” requirement for banks acting as trustees and in other limited capacities (as well as for qualified investors) to be able to make investments in money market funds that pay 12b-1 fees
 - a revision of the 9 to 1 exemption that substantially reduces the procedural requirements and allows the exemption to be utilized on a line-of-business basis, on a bank-wide basis, and for accounts that predate the development of an account-by-account compliance system
 - a personal trust account exemption for personal trust accounts that were established prior to this proposal
 - a conditional safe harbor that allows banks to measure their compensation in one year to determine their status for the next year and provides appropriate cure periods
 - an account-by-account exemption that would give a bank some additional flexibility when evaluating individual accounts for which its compensation would not meet the “chiefly compensated” comparison. This exemption would also provide formulas to allocate “sales

compensation” (which goes into the comparison) from sources such as mutual funds that are paid on an aggregate basis.

- an exemption, retained from the Interim Rules, for a bank acting as an indenture trustee

Bank Custody Exception

The safekeeping and custody exception gives a bank, acting as a custodian, legal certainty that it may engage in specified securities transactions while holding the funds and securities related to those transactions. This exception lists transactions that a bank may undertake for investors, and permits a bank to provide “related administrative services” to retirement and benefit plans. The Interim Rules provided banks with two exemptions – one for small banks and one for all banks. Both exemptions contained solicitation, compensation, and staffing limits that were designed to allow banks to engage in a small number of accommodation trades, but not to run a large-scale brokerage business without the investor protections of the federal securities laws.

The Commission will consider proposing to

- retain the small bank custody exemption, but make it available to more banks, and eliminate many of its restrictions by:
 - establishing a \$100,000 revenue limit for securities transactions effected under the exemption, including transactions in trust accounts if other trust exemptions are not utilized
 - defining a “small bank” as a bank with \$500 million in assets that is not associated with a broker-dealer
 - retaining the condition that a small bank may not qualify for this exemption if it is a part of large bank holding company with more than \$1 billion in consolidated assets
 - extending the exemption to include transactions in all securities
 - permitting small banks to enter into networking arrangements with unaffiliated broker-dealers and use dual employees (*i.e.*, bank employees that are also registered representatives of an unaffiliated broker-dealer) to effect securities transactions
- retain the general bank custody exemption with modifications that would
 - permit a bank to accept securities orders so long as the fees it receives for clearing and settling securities transactions do not vary, directly or indirectly, based on whether the bank accepts an order to purchase or sell a security
 - limit the availability of this exemption to “qualified investors” as defined in Exchange Act Section 3(a)(54) on a going forward basis

- grandfather all existing custody accounts to avoid disrupting existing custody relationships
- permit a bank to continue to receive 12b-1 or shareholder servicing fees for these custody accounts
- continue to permit a bank to pass any executing broker-dealer's charges through to the customer

Other New Bank Exemptions

The Commission will consider proposing three new targeted exemptions in recognition of banks' existing business practices. These exemptions would

- permit a bank to effect transactions for qualified investors, trustee and fiduciary accounts, and certain agency accounts, including escrow agency accounts, in money market funds that pay 12b-1 fees
- permit bank trustees and non-fiduciary administrators to receive asset-based sales charges and service fees from mutual funds to offset plan administration fees
- permit a bank, under limited conditions, to sell securities that are exempt from registration under Regulation S to non-U.S. persons who are located outside of the U.S.

Other Financial Institution Exemptions

The Commission will consider whether to extend by exemption appropriate exceptions and exemptions to thrifts and credit unions based on their current securities activities. Comment will be solicited on whether additional exemptions are needed.