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April 18, 2002

Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Re: Research Analyst Conflicts of Interest; SR-NASD-2002-21 and SR-NYSE-2002-09; 67 Federal Register 11526 (March 14, 2002).

Dear Mr. Katz:

The American Bankers Association (“ABA”)¹ and the ABA Securities Association (“ABASA”)² appreciate the opportunity to comment on two proposals filed with the Securities and Exchange Commission (“SEC”) by the National Association of Securities Dealers (“NASD”) and the New York Stock Exchange (“NYSE”) (hereinafter collectively referred to as “self-regulatory organizations” or “SROs”). The SRO proposals would amend their rules to address research analyst conflicts of interest.³

The proposed rules are intended to improve the objectivity of research and provide investors with more useful and reliable information when making investment decisions. To that end, the proposals, among other things, seek to minimize the influence that a broker-dealer firm’s investment banking department has over its research department and would restrict analyst’s personal trading of securities. In addition, the proposal would require disclosure of financial interests held by the broker-dealer firm, the analyst and his or her family members, and any other material conflict of interest associated with a recommendation of a security.

The ABA and ABASA have long championed public and private efforts to strengthen investor confidence in our capital markets and we believe that many of the SRO proposals will do much to improve public confidence in our markets. As trade associations representing, among others, holding companies

¹ The ABA brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership—which includes community, regional, and money center banks and bank holding companies, as well as savings associations, trust companies, and savings banks—makes ABA the largest banking trade association in the country.

² ABASA is a separately chartered affiliate of the ABA representing those holding company members of the ABA that are most actively engaged in securities underwriting and dealing activities, offering proprietary mutual funds, and derivative activities.

³ The NASD would establish new Rule 2711, while the NYSE would propose amendments to existing Rule 472.

involved in offering customers access to all financial services and products through commercial banks, broker-dealer firms and insurance agencies, we wish to offer, from our unique vantage point, some constructive comments on how the SRO proposals could be improved.

Disclosure Requirements

Disclosure of Beneficial Ownership Interests

Both proposed NASD Rule 2711 and the proposed revisions to NYSE Rule 472 would require that member firms disclose in research reports and research analysts disclose in public appearances whether the member firm or its affiliates beneficially own 1% or more of any class of common equity securities of the subject company. Beneficial ownership would be determined as of five business days before the publication of the research report by the firm or the public appearance by the analyst. In addition, proposed revision to NYSE Rule 472 provides that beneficial ownership is to be based upon the same standards used to compute ownership for purposes of the reporting requirements under Section 13(d) of the Securities Exchange Act of 1934.

While the ABA and ABASA appreciate the need for and importance of such disclosure, careful consideration should be given to the impact this disclosure requirement would have on those member firms and employees affiliated⁴ with bank trust departments.⁵ As the Commission is aware, many broker-dealers are affiliated with banks authorized to provide trust and fiduciary services, as well as state and federally-chartered trust companies. Indeed over 2,100 banks serve as either trustee or fiduciary to over 26 million accounts with a total value in excess of \$23 trillion.⁶ Of the \$23 trillion in fiduciary assets held by bank trust companies, over \$2.4 trillion is invested in common and preferred stocks. Clearly the potential impact is huge.

Specifically, we are concerned that broker-dealers affiliated with bank trust departments will be heavily burdened by this disclosure requirement. It is not uncommon to find many trust accounts holding a large percentage of stock in one particular company. For example, employee benefit accounts may hold large amounts of employer stock through 401(K) plans. Testamentary trusts may also hold significant amounts of stock in the company that the testator founded and took public. In setting up the trust, the testator may have directed the trustee to hold the stock and only sell, if at all, in the most rare circumstances. In addition, commingled funds, such as common and collective funds, are often structured to address innovative

⁴ We note that neither proposal contains a definition of the term “affiliate.” For purposes of this discussion only, we interpret the term “affiliate” by reference to the concept of directly or indirectly controlling, controlled by or under common control as used in the Investment Company Act of 1940 and the Bank Holding Company Act. Our interpretation should not be viewed as an endorsement of that interpretation. Indeed, for many of the same reasons discussed in this letter, we would support a much narrower definition of the term “affiliate.”

⁵ The term “bank trust department” is intended to collectively refer to all financial institutions exercising trust powers including federal and state-chartered savings associations, federal and state-chartered commercial banks, and federal and state-chartered trust companies.

⁶ Federal Financial Institutions Examination Council, Trust Assets of Financial Institutions – 2000.

investment opportunities and, as a consequence, may hold a significant percentage of a company's outstanding equity.⁷ Numerous other examples abound.

In addition, banks, by virtue of either their voting authority or investment discretion, are beneficial owners and comply with the reporting requirements mandated by Section 13(d) of the Securities and Exchange Act based on their aggregate fiduciary holdings. Thus, even in those situations where individual fiduciary accounts do not hold any significant amount of stock, bank trust departments will still be required to report aggregate beneficial holdings to the Commission.

To minimize the burdens associated with this proposal, we would urge that several steps be taken. First and at a minimum, the SROs should raise the percentage threshold for determining beneficial ownership to more closely coincide with those levels that currently trigger reporting requirements under Section 13(d). Specifically, rather than the 1% level proposed, SRO rules should require disclosure only when beneficial ownership reaches 5% of any one class of equity securities.

Second, reporting burdens could be further minimized if the SRO rules made a distinction between beneficial ownership status acquired as a result of voting authority, as opposed to investment discretion. Specifically, the rules should only require disclosure when affiliates beneficially own equity securities as a result of their investment discretion, not when they beneficially own only as result of exercising voting authority. It is not uncommon for bank trust departments to take investment direction from unaffiliated persons, including employee benefit plan participants and investment advisers. In these situations, bank trust departments only assume the mantle of beneficial ownership because they, as record holders of the securities, are required, under state law, to vote the securities. Voting authority when combined with research analyst recommendations would not seem to present the same degree of concern presented by affiliates exercising both investment discretion and making investment recommendations.

Disclosure of Receipt of Compensation

The proposed SRO rules would require broker-dealer firms to disclose in a research report whether the firm or its affiliates received, within the last twelve months, compensation from the company that is the subject of the research report or reasonably expects to receive compensation from the company within three months of the report's publication. In addition, a research analyst must disclose in public appearances if the analyst knows or has reason to know that the company that is the subject of the research report is a client of the broker-dealer or its affiliates.

Again we would suggest that this disclosure requirement, while well-intentioned, is overly broad and would pose enormous burdens for broker-dealer firms affiliated with banks. Many banks serve as custodians or recordkeepers to company pension plans. Banks may also provide payroll processing services, cash management, cashier's, certified or travelers checks services, corporate credit cards, and travel agency services. Compensation not tied to the share value of a publicly-traded company should not be required to be disclosed in research reports.

⁷ Our concerns with respect to commingled funds managed by bank trust departments would also apply equally to registered investment companies advised and therefore beneficially owned under Section 13(d) either by registered investment advisers housed in the bank or by affiliated investment advisory firms.

In addition, many of our members have expressed concern about letting broker-dealer firms know that the bank or bank trust department has a client relationship with a specific company. High information barriers erected as a result of concerns about insider trading liability and potential allegations regarding breach of fiduciary duties have fostered an atmosphere where this type of information is only shared on a need to know basis. Regulatory efforts that mandate broad brush disclosures of bank customer identities could force breaches in these high information barriers and lead to liability under federal securities laws, state and federal fiduciary laws, or both.

Restrictions on Personal Trading by Research Analysts

The proposed SRO rules would prohibit research analysts from purchasing or receiving equity securities under several different scenarios, including the prohibition on purchasing securities of any company that the analyst follows for a set time period before and after the publication of the analyst's report on the company. We believe many of these prohibitions make good sense and support their adoption. Our concern, however, rests with the exceptions and the uneven playing field it would create between banks and other financial services providers.

Specifically, the SRO rules provide exceptions to the prohibition on purchasing securities that would allow analysts to purchase shares of a registered investment company. Bank collective funds often compete with registered investment companies for employee benefit plan business. For example, employee/plan participants are offered an array of investment choices through their 401(K) plans. These investment selections can and often do include mutual funds, collective investment funds, or both. The carve-out for registered mutual funds will effectively allow registered mutual funds to lock up broker-dealer 401(K) business to the detriment of bank collective investment funds.⁸ We would urge the SROs to expand the exceptions to include bank collective investment funds.

In conclusion, the ABA and ABASA appreciate the opportunity to offer our views on these proposals. We would welcome the opportunity to meet with appropriate Commission and/or SRO staff to discuss further our concerns. Should you wish to do so, please do not hesitate to contact the undersigned.

Sincerely yours,

Sarah A. Miller

⁸ To be sure, financial holding companies often do offer plan sponsors access to affiliated and third-party mutual funds, as well as bank collective funds. Our position is that the plan sponsor should be able to make decisions on which pooled products to offer its employees unfettered by SRO rules that unintentionally give an advantage to one pooled product purveyor over another.