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March 20, 2001

DRAFT

January 26, 2001

Ms. Catherine McGuire
Associate Director and Chief Counsel
Division of Market Regulation
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20036

RE: Title II of Gramm-Leach-Bliley Act, Pub. L. No. 106-102

Dear Caite:

By this letter¹, the American Bankers Association (“ABA”) and the ABA Securities Association (“ABASA”)² hereby supplement their November 7, 2000, request for guidance³ to address several other issues raised by Title II of the Gramm-Leach-Bliley Act. Specifically, this letter requests the staff of the Securities and Exchange Commission (“Commission”) to address the following issues:

- The definition of the term “chiefly” as used in new Section 3(a)(4)(B)(ii).

¹ As was suggested at an earlier meeting, this letter is being submitted in draft form.

² 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 holding companies, as well as savings associations, trust companies, and savings banks—makes ABA the largest banking trade association in the country.

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

³ Our earlier letter involved the application of new subsection (C) to Section 3(a)(4) of the Securities Exchange Act of 1934 when the purchase of mutual fund shares are involved.

- The method by which “chiefly” is to be calculated.

- A confirmation that execution of customer directed orders on the part of a custodian bank comes within the safekeeping and custody exception of new Section 3(a)(4)(B)(viii).

Definition of “chiefly”

The compensation requirements applicable to the trust and fiduciary exemption¹ require that a bank or trust company (hereinafter referred to collectively as “bank”) be “chiefly” compensated based on an annual or administrative fee², a fee based on assets under management, a flat or capped per order processing fee, or any combination of these fees.

It is our understanding from our last meeting that the staff would agree that “chiefly” means “greater than 50 percent.” Consequently, if a trust department received an annual or administrative fee, a fee based on assets under management, a flat or capped per order processing fee reflective of the cost of the transaction only, or any combination of these fees, and these fees totaled more than 50 percent of the compensation, then the trust and fiduciary exemption’s “chiefly” requirement would be satisfied irrespective of the other types of fees that make up the remaining percentage (less than 50 percent) of fees received. We request confirmation of this interpretation.

Calculation of “chiefly”

We also request clarification regarding calculation of “chiefly”. We strongly urge the staff to permit the calculation of compensation for trust and fiduciary activities to be performed on a line-of-business basis. A line-of-business basis would comport with current bank practices, systems capabilities, and regulatory reporting requirements; would not result in increased regulatory burden for bank trust and fiduciary departments; and would be consistent with Congressional purposes in enacting the exemption.

¹ Section 3(a)(4)(B)(ii)(I) provides that a bank must be “chiefly compensated for ...[fiduciary]...transactions, ..., on the basis of an administrative or annual fee (payable on a monthly, quarterly, or other basis), a percentage of assets under management, or a flat or capped per order processing fee equal to not more than the cost incurred by the bank in connection with executing securities transactions, for trustee and fiduciary customers, or any combination of such fees;...”

² Bank trustees may receive administrative or shareholder servicing fees from mutual funds in connection with the investment of plan assets. See Department of Labor Advisory Opinions 97-15A and 97-16A (May 22, 1997).

Current bank reporting requirements. Banks and regulators use line-of-business in order to track fiduciary fees, manage fiduciary business lines, and report fiduciary business to bank regulators. Specifically, banks and trust companies generally charge fees for fiduciary services according to fee schedules that vary from business line to business line.

In addition, many bank trust departments and trust companies currently generate internal tracking reports along lines of business. For example, bank trust departments generate monthly management reports that track, on a business-line basis, revenues earned and expenses incurred.¹ Finally, bank regulatory reports also require income earned by bank trust departments to be reported on a line-of-business basis.² In short, fees are generally tracked and aggregated on a line-of-business basis, and not on the more “granular” basis of types of fees charged to individual customers or accounts.

Regulatory Burden of Other Types of Calculations. Making the “chiefly” calculation on a more detailed or “granular” basis, such as account-by-account or customer-by-customer, would, in many cases, be extremely burdensome and practically unworkable. Expensive new software would have to be developed and installed; systems would have to be substantially reconfigured; and such fine-tuned reporting would become much more complex and burdensome. The banking industry’s experience with similarly detailed and burdensome reporting requirements in the Section 20 “principally engaged” context -- which did not even extend to account-by-account calculations -- was extremely negative.

We see no need to proceed down a similar path in this context absent a critical need to do so, which we believe is simply not present. In fact, it is our belief that the vast majority of institutions will not tread closely to the “chiefly” line given the types of “eligible” fees that are typically charged for this business, *i.e.*, fees for assets under management, processing fees, etc., which would clearly fall in the “chiefly” category. As a result, the installation of costly software, reporting, and compliance systems to confirm that result would constitute regulatory overkill.³ Indeed, the very cost of such a system could well cause many institutions to “push-out” traditional trust and fiduciary activities

¹ Flexibility on the part of the Commission regarding frequency of calculations is strongly urged. Bank trust and fiduciary departments should not be required to perform these calculations any more frequently than is currently required under either existing reporting regimes or internal tracking reports.

² See, e.g., Schedule E to the Annual Report of Trust Assets (Form FFIEC 001); Consolidated Reports of Condition and Income (Quarterly Call Reports) (Form FFIEC 041).

³ Any notion of even more detailed reporting, *e.g.*, on a transaction-by-transaction basis, would be plainly unworkable because of the expense of cost allocation systems. That is, it would be virtually impossible to devise a system that would allocate and calculate the proportion of non-transactional fees, such as ones for administration and assets-under-management, to a particular transaction in a particular account.

to a broker-dealer -- which is the very result that the push-out exemption for such activities is expressly intended to avoid.¹

Detailed Reporting Not Required by Statute. Nothing in the Gramm-Leach-Bliley exemption from push-outs for fiduciary activities requires calculations to be made on other than a line-of-business basis. The purpose of the exemption is to allow banks to keep in the bank the types of trust and fiduciary activities that banks have engaged in for many, many years, even where a substantial portion of those activities could involve fees that would otherwise trigger broker registration requirements.² Congress recognized that, unlike several other of the push-out exemptions, where banks conduct securities transactions in their fiduciary capacity they are subject to an entirely separate scheme of bank fiduciary regulation. In that context, where customers have alternative regulatory protections, the statute expressly recognizes that securities activities ought to be permissible in the bank even where there are significant amounts of transaction-based compensation. Of course, the “chiefly” language, along with the requirement of separate broker-dealer execution of securities trades resulting from fiduciary activities, ensures that the trust exemption may not be used simply to transfer a full-scale securities brokerage into a trust department to evade Commission regulation.

In this context, our members believe that line-of-business reporting should be permitted to make the necessary “chiefly” calculation. Such reporting would not allow full-service securities firms to evade Commission regulation by transferring their businesses *in toto* to a bank’s trust department. No evasion of fiduciary regulation of these activities could occur, as such regulation is a condition of this exemption. And, finally, there would not be imposed the kind of regulatory burden that could, as a practical matter for many banks, require the very push-out of customary bank fiduciary activities that Congress expressly sought to avoid.

Order-taking activities

¹ Moreover, when “chiefly” is calculated on a line-of-business basis, no need exists to grandfather certain types of pre-existing trust and fiduciary accounts that cannot comply with the compensation restrictions of new Section 3a(4)(B)(ii). These accounts, although few in number on a per bank basis, involve irrevocable accounts established years ago where the underlying trust instrument specifies that the trustee’s sole or primary compensation is transaction based.

² See Conference Report to Accompany S. 900, reprinted in Congressional Record, 145 Cong. Rec. H11255, H11297 (November 2, 1999).

A bank that engages in safekeeping and custody activities in accordance with the conditions outlined in clause (viii) of subparagraph (B) will not be considered a broker within the meaning of Section 3(a)(4)(A) of the Securities Exchange Act of 1934.¹

Questions have been raised concerning whether the exemption includes or encompasses those situations where a custodial bank takes an order for the purchase or sale of securities from a customer and transmits that order to an executing broker-dealer. As demonstrated below, order taking comes within the ambit of “custody services” and is, accordingly, not “pushed out.”

It is clear that in enacting the various exemptions from push-out, Congress intended that banks be permitted to engage directly in the bank in certain activities involving securities transaction in which banks have traditionally engaged. See Conference Report to Accompany S. 900, reprinted in Congressional Record, 145 Cong. Rec. H11255, H11297 (November 2, 1999). Order taking or buying or selling securities at customer direction and as an adjunct to custody relationships has long been a custody service provided by banks. Recognized authorities in trust and fiduciary law tell us that custody services include safekeeping of securities; collecting income; collecting matured or called principal; notifying the customer of subscription right; and **buying, selling**, receiving and delivering of securities on specific directions from the customer (emphasis added).²

The specific language of the exemption further supports the conclusion that Congress intended to include all traditional custodial services within the safekeeping and custody exception by referencing safekeeping and custody services as part of customary banking activities. Clearly, customary custody services include taking a customer’s order to purchase or sell securities.

In providing for a safekeeping and custody exemption, Congress clearly understood that bank custodians take direction regarding the purchase and sale of securities from individual clients and provided that that direction should be transmitted to a registered broker-dealer for execution. Specifically, Section 3(a)(4)(C) directs banks and trust companies conducting securities transactions under the auspices of the safekeeping and custody exemption, as well as the trust and fiduciary and stock purchase plan exceptions, to transmit publicly traded security buy or sell orders to a registered

¹ Clause (viii) provides that “[t]he bank, as part of customary banking activities –(aa) provides safekeeping or custody services with respect to securities, including the exercise of warrants and other rights on behalf of customers; (bb) facilitates the transfer of funds or securities, as a custodian or a clearing agency in connection with the clearance and settlement of its customers’ transactions in securities, (cc) effects securities lending or borrowing transactions with or on behalf of customers as part of services provided to customers pursuant to division (aa) or (bb) or invests cash collateral pledged in connection with such transactions; (dd) ... (ee) serves as a custodian or provider of other related administrative services to any individual retirement account, pension, retirement, profit sharing, bonus, thrift savings, incentive or other similar benefit plan.”

² See the definition of custodian in Banking Terminology (2nd edition), a publication of the American Institute of Banking; the discussion of the responsibilities of a custodian in Trust Business, published by the American Institute of Banking in 1934; Section 8.1 of Scott on Trusts; FDIC Trust Examination Manual, Vol. 1 at 4-9 (1997); Clarke, Zalaha, and Zinsser, The Trust Business at 67 (1988); discussion of custodial accounts in Trust Audit Manual, (1976), a publication of the Bank Administration Institute; What a Trust Department Does at 34 (1940), a publication of Continental Illinois National Bank.



broker-dealer for execution. Paragraph (C) is not limited in its application; it applies to all activities exempt under the safekeeping and custody exception.

We would also note that Division (ee) to the exemption recognizes that banks will take direction from bank customers. That division provides an exemption for those banks serving as custodians or providers of administrative services to self-directed individual retirement accounts. This exemption does not contemplate that the bank as custodian or provider of services will become involved in the transaction only after the trade has been executed. Rather the self-directed IRA provision illustrates quite clearly that Congress understood and embraced the notion that banks would remain exempt from broker-dealer registration even if they took direction from an individual customer and transmitted that order to a broker-dealer for execution.

CONCLUSION

The ABA and ABASA appreciate the opportunity to meet with you to discuss these and other issues of importance to the banking community. As you know, the May 12, 2001 effective date for compliance with Title II is fast approaching, a prompt response to these issues would be most appreciated.

Sincerely yours,

Sarah A. Miller

cc: Robert L.D. Colby
 Lourdes Gonzalez