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Memo

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Date: March 5, 2002

To: Richard B. Smith, Chairman of Drafting Committee
Dean Joel Seligman, Reporter for Drafting Committee

Re: February 18, 2002 Working Draft of Uniform Securities Act (USA) for April 19-21

We appreciate this opportunity to comment on the referenced working draft. This memo reflects the views of the American Bankers Association ("ABA"),[1] the ABA Securities Association ("ABASA"),[2] and the New York Clearing House Association L.L.C. ("Clearing House").[3] Our comments are also consistent with the views of many state bankers associations ("SBA's").

For years the ABA and state bankers associations have worked together to meet the needs of one another, our members, and ultimately the financial services industry. Through diligent efforts a strong alliance has been formed to increase the effectiveness of the banking industry's state and federal government relations programs. The state associations have provided considerable feedback and recommendations on the various drafts of USA, and ABA is grateful for their advice. ABA will continue to share information with state associations to assist them in responding to uniform law proposals in the state legislatures.

We appreciate the consideration that the USA Committee Chair, Reporter, and Members have given our views during the drafting process. In particular, we thank the Reporter for hosting several informal meetings for interested parties. These meetings were beneficial, and the hospitality provided was most generous.

Listed below are some significant issues that we have identified to date.

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[1] The ABA brings together all categories of banking institutions. 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 derivatives activities.
[3] The Clearing House is an association of major commercial banks. The members are Bank of America, National Association, The Bank of New York, Bank One, National Association, Bankers Trust Company, Citibank, N.A., First Union National Bank, Fleet National Bank, HSBC Bank USA, JPMorgan Chase Bank, LaSalle Bank National Association and Wells Fargo Bank, National Association.

BROKER-DEALER AND RELATED ISSUES [SECTION 102(4)]

1. Positive Changes. This draft recognizes that a bank or savings institution performing certain push-out activities is excluded from the definition of broker-dealer in Section 102(4). We agree that this should be an exclusion rather than a simple exemption from registration under Section 401. As the Reporter has correctly noted, the "exclusion" treatment is consistent with the 1956 and 1985 versions of the Uniform Securities Act and the Securities Exchange Act of 1934. This drafting style has worked effectively, and there is no reason to deviate from a proven technique.

Similarly, we applaud elimination of the unnecessary provision limiting sales under the dealer push-out exemptions to institutional investors. This limitation would have effectively precluded all banks from selling commercial paper, bankers acceptances, commercial bills, government securities, and municipal securities to any natural person and/or most institutional customers with assets of less than $25 million. In addition, banks would have been effectively prevented from offering trust and fiduciary services to natural persons or institutional customers with assets under $25 million. This restriction would have been a serious mistake and would have generated widespread banking opposition.

The above two revisions are important to our industry, and we are grateful for these changes.

2. Objections – Elimination of De Minimis and Private Placement Provisions. At the same time we continue to object to elimination in Section 102(4)(C) of the de minimis and private placement push-out exemptions. Proponents of elimination have cited no demonstrated need nor provided any evidence of abuse to justify their position. The Gramm-Leach-Bliley (G-L-B) Act appropriately recognizes that traditional banking activities involving securities transactions – including the de minimis and private placement ones – do not make a bank a broker or dealer nor require registration. No valid public policy interests would be served by denying banks the ability to provide banking products in the most effective and efficient distribution system, thereby depriving consumers and businesses of these benefits, especially where to do so would manifestly defeat the Congressional purpose in enacting the push-out exemptions.

• Preemption Issues. The Supremacy Clause of the United States Constitution expressly prohibits state law from interfering with rights conferred by federal law.[4] It has been the longstanding position of the Comptroller of the Currency (the regulator of national banks) that state laws which limit the exercise of authorized powers by national banks are preempted by the Supremacy Clause. For example, in 1993 the Comptroller ruled that a national bank offering trust services, including investment advisory services to its trust customers, does not have to register with the State of Texas as an investment advisor since federal law preempts the Texas Securities Act

[4] U.S. Constitution, Art. VI, Clause 2.

in this respect.[5] The OCC said that federal law preempts the Texas Act because the latter requires the bank to obtain state approval (through a state license) to conduct activities authorized for national banks under federal law. Moreover, federal law and regulations expressly preempt laws providing for state examination of a national bank's books and records since federal law severely restricts the ability of state authorities to exercise visitorial rights over national banks.[6] OCC regulations provide that "[s]tate officials may not exercise visitorial powers with respect to national banks, such as conducting examinations, inspecting or requiring the production of books or records of national banks, or prosecuting enforcement actions, except in limited circumstances authorized by federal law."[7]

Similarly, the Chief Counsel for the Comptroller of the Currency ruled in 1992 that federal law preempts an Iowa statute which required national banks performing discount brokerage activities in Iowa to register with the state as broker-dealers. The ruling also noted that federal law preempts an Iowa provision which authorized the state to examine national banks performing brokerage activity.[8]

In summation the OCC has issued numerous opinions concluding that federal law preempts state laws requiring either national banks or their employees to obtain licenses or register to conduct activities authorized for national banks under federal law or to submit to examination by the state. These opinions are consistent with federal court decisions. For example, the United States Court of Appeals for the Eighth Circuit has held that state law cannot prohibit a national bank from conducting an activity permissible under federal law or require a state license as a condition to conducting the activity.[9]

The present case is identical with the above situations. By eliminating the de minimis and private placement exclusions, a state would effectively be preventing banks from providing products and services authorized by federal law. A bank would be forced to register with the state to offer a federally authorized service -- something the OCC says cannot be required. While it is clear that such provision must fail under the Supremacy Clause with respect to national banks, we believe the comprehensive nature and broad language of the G-L-B Act dictate the same result for state-chartered banks. Indeed, by its terms the federal law push-out provisions apply to a "bank" – not just a national bank. In addition, it would certainly be ironic and incongruous to find that Congress intended to place state-chartered banks at a competitive disadvantage. We recognize that the Gramm-Leach-Bliley Act contains provisions permitting regulation of securities activities of a functionally regulated subsidiary of a depository institution by the SEC and state securities authorities.[10] However, there are important limitations, such as ones relating to depository institutions and push-out exemptions, that blunt the impact of functional regulation

[5] OCC Interpretive Letter No. 628 (July 19, 1993).
[6] 12 U.S.C. Sec. 484.
[7] 12 C.F.R. Sec 7.4000.
[8] Letter from William P. Bowden, OCC Chief Counsel (December 7, 1992).
[9] First National Bank of Eastern Arkansas v. Taylor, 907 F.2d 775 (8^{th} Cir. 1990).
[10] See Sec. 111.

by allowing banks to conduct certain securities activities in the bank. For example, a bank performing excluded securities activities is not a functionally regulated subsidiary.

As noted above, federal law and many preemption decisions severely restrict (1) the ability of state authorities to exercise visitorial rights over national banks or (2) the obligation of such banks to submit to examination by the states. The OCC has repeatedly advised national banks that the most prudent course is only to submit to inspection under compulsory process of state or federal court order due to potential liability for the unauthorized disclosure of confidential and privileged information about customers.[11] At a minimum the above precedents raise doubts regarding the validity of USA provisions requiring inspection and examination of national bank books and records. We urge a thorough review of these provisions and incorporation of necessary amendments to comply with federal law.

• Practical Considerations. Apart from the above *legal* limitations, there are practical reasons for including the de minimis and private placement provisions in USA. Among other things, Congress included the de minimis power to permit accommodation trades for certain bank customers. Community banks and others have advised us that this is critical to them and their customers, particularly where no registered broker is located in the town. With respect to private placements, there is historical precedent for this authority. Federal banking regulators have long permitted banks to engage in private placement activities.[12] Banks have provided such services for years as an adjunct to granting credit to customers. Federal law imposes significant safety and soundness type limits on banks' use of the power. These include provisions requiring compliance with numerous federal laws and regulations, restrictions on affiliation, and aggregate capital limits.[13] If a depository institution is engaging in an "unsafe or unsound" practice, the appropriate federal banking agency may issue a cease and desist order.[14]

Section 204 of the G-L-B Act requires that federal bank regulators, after consulting with the SEC, adopt recordkeeping requirements for banks relying on the push-out provisions. A bank will be examined for compliance by its appropriate federal banking agency. Banks are also subject to the Interagency Statement on Retail Sales of Nondeposit Investment Products.[15] Banks must comply with numerous rules relating to recordkeeping and confirmation requirements, securities trading policies, insider trading, and government securities suitability standards.[16] In short, use of the federal push-out exemptions does not mean that banks' activities are unregulated. It is also not feasible for a bank to register as a broker-dealer because the SEC's net

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[11] OCC Interpretive Letter No. 628 (July 19, 1993).
[12] See SEC Release No. 34-44570, File N. S7-12-01 (July 18, 2001) and SEC Release No. 34-44569, File No. S7-12-01.
[13] See Section 3(a)(4)(B)(vii) of the Securities Exchange Act of 1934 [15 U.S.C. Sec. 78c(a)(4)].
[14] 12 U.S.C. Sec. 1818(b).
[15] The Interagency Statement was jointly issued by the Federal Reserve Board, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision on February 15, 1994. It was subsequently amended on September 15, 1995.
[16] See Securities Activities of Banks (Third Edition) by Melanie L. Fein, Sec. 6.04.

capital rule imposes a 100% haircut on illiquid assets such as loans. Moreover, it is impractical for many small banks to establish broker-dealer affiliates.[17] Significantly, the SEC also believes that it is not a viable option for a bank to register as a broker-dealer because of the disparate capital and regulatory requirements applicable to banks and securities firms.[18]

• Nonuniformity and Opposition. It goes without saying that at a minimum, if all the G-L-B Act push-out provisions are not included in USA, many state bankers associations (SBA's) will attempt to secure their enactment in state legislatures. Other SBA's will oppose the Act altogether. SBA's and banks may justifiably question the benefit of a USA that eliminates critical banking provisions since both the 1956 and 1985 versions of USA EXCLUDE banks (or depository institutions in the 1985 Act) ENTIRELY from the broker-dealer definition. The ultimate result will be nonuniformity among the states – an outcome obviously contrary to the purpose of this three-year project.

3. Other Needed Changes. Additional revisions are needed to Section 102(4). First, entities exempted by Section 3(a)(4)(E) of the Securities Exchange Act of 1934 should be accorded similar treatment under USA. Otherwise, these entities may be faced with securing exclusions from multiple state administrators. Second, because the SEC has not finalized rules regarding broker and dealer exemptions for banks and savings institutions, a flexible state statutory provision is needed to recognize the effect of these forthcoming regulations. The SEC has extended the temporary exemptions from the definitions of "broker" and "dealer" for banks and savings institutions until May 12, 2002, and has given notice that it expects to extend further this date as appropriate so that banks will have a sufficient transition period to bring their operations into compliance with the new statutory scheme and amended rules. The SEC has recognized that banks may need as much as a year to develop compliance systems to adapt to the G-L-B Act in light of the amended rules.[19] As recently as February 22, 2002, the Commission reiterated that it expects to extend the compliance period as appropriate.[20] A state provision (such as that noted below) recognizing the effect of these federal regulations would assist banks in their compliance efforts and reduce regulatory burden. We are also very concerned about USA's overall effective date. Given the uncertainty regarding the terms of anticipated SEC regulations and the importance of an adequate transition period, we recommend that the Act's effective date be delayed to accommodate these factors.

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[17] See Securities Activities of Banks (Third Edition) by Melanie L. Fein, Sec. 3.04[B][5][d].
[18] See SEC Release No. 34-44570, File No. S7-12-01 (July 18, 2001) and SEC Release No. 34-44569, File No. S7-12-01.
[19] See SEC Release No. 34-44570, File No. S7-12-01 (July 18, 2001) and SEC Release No. 34-44569, File No.S7-12-01.
[20] See SEC Statement contained in SEC News Digest (February 22, 2002).

4. Recommended Amendments. We suggest consideration of the following amendments to effectuate the above recommendations relating to broker-dealer issues:

• Amend Section 102(4)(C) by striking paragraph (C) in its entirety and substituting in lieu thereof the following:

(C) a bank or savings institution if its broker-dealer activities are limited to those specified in Sections 3(a)(4)(B), 3(a)(5)(B), and 3(a)(5)(C) of the Securities Exchange Act of 1934 and to other activities excepted from such Act's definition of "broker" or "dealer" by statute, regulation, rule, order, opinion, or letter; or an entity excepted under Section 3(a)(4)(E) of such Act;

• Appropriate language should be included in USA that recognizes the severe limitations on banks' being subject to visitorial powers, such as those affecting national banks contained in 12 U.S.C. Sec. 484 and 12 C.F.R. Sec. 7.4000.

• The Act's effective date should be delayed for reasons outlined in #3 (above).

DEPOSITORY INSTITUTION ISSUES [SECTION 102(5)]

The definition of depository institution in Section 102(5) should be clarified. During the last St. Louis meeting, I again stressed the need for clarification and understood that this draft would reflect the following **recommended amendment:**

• Recommended Amendment. Amend Section 102(5) by striking "a bank, or" and inserting in lieu thereof the following:

"(A) a bank; or

(B) [insert language in Draft beginning with "a savings institution . . ."].

(Subsequent paragraph letters in this Subsection will probably need to be re-designated.)

My understanding is that the definition of depository institution is intended to include a "bank" as defined in Section 102(3). The above clarification is needed to reflect this intent. Note that if this clarification is not made, amendments in other sections of the draft will be necessary.

INVESTMENT ADVISER ISSUES [SECTION 102(15)]

1. Explanation for Section 102(15)(F). We appreciate the specific exclusion from the investment adviser definition in Section 102(15) for a bank or depository institution. The Reporter asked for a brief explanation of the need for this exclusion.

We are concerned that the present general exclusion language in paragraph (G) for a person excluded in the Investment Advisers Act of 1940 may not extend to a savings institution. There is an exclusion in the Investment Advisors Act for a bank, but a "bank" is defined in virtually the same way as "bank" in the Securities Exchange Act of 1934. Historically, the SEC has determined that savings institutions are not "banks" as defined in Exchange Act Section 3(a)(6). More recently, however, the SEC has recognized that the differences between banks and savings institutions have narrowed and has ordered that savings associations (like banks) are exempt from the definitions of "broker" and "dealer" under the Exchange Act until May 12, 2002.[21] The 1956 version of USA has a specific exclusion from the definition of investment adviser for a savings institution. The 1985 version has an exclusion for a depository institution. Certainty is needed in this area, and it seems reasonable to bring forward the USA's existing exclusion for savings institutions, especially considering their similarities with banks.

2. Additional Amendment Needed. Flexibility is required in this area to accommodate additional exclusions that might be provided by federal regulations and actions. For this reason, we recommend the following amendment:

Amend Section 102(15)(G) by inserting the following immediately before the semicolon (;): "or by Securities and Exchange Commission rule, regulation, or order under such Act".

BANK ISSUES [SECTION 102(3)]

We recognize that the definition of "bank" in Section 102(3) is almost identical to that in the Securities Exchange Act of 1934. Historically, the SEC has said that savings institutions are not "banks" as defined in Exchange Act Section 3(a)(6). More recently, however, the SEC has recognized that the differences between banks and savings institutions have narrowed and has ordered that savings associations (like banks) are exempt from the definitions of "broker" and "dealer" under the Exchange Act until May 12, 2002. The SEC found that extending the exemption for banks to savings associations is necessary or appropriate in the public interest and is consistent with the protection of investors.[22]

This draft uses the terms "bank" and "depository institution" but not always together. We are concerned that when a particular USA provision refers only to "bank," it may be interpreted not to include a savings institution. For clarification and legal certainty, we recommend the following amendment:

• Recommended Amendment. Amend Section 102(3)(C) by inserting the following after "institution,": "including a savings institution,".

[21] SEC Release No. 34-44570, File No. S7-12-01 (July 18, 2001) and SEC Release No. 34-44569, File No. S7-12-01.
[22] SEC Release No. 34-44570, File No. S7-12-01 (July 18, 2001) and SEC Release No. 34-44569, File No. S7-12-01.

INSTITUTIONAL INVESTOR ISSUES [SECTION 102(11)]

On several occasions we have recommended generally reducing to $5 million from $25 million the institutional investor thresholds in Section 102(11) and making the other changes noted below. In many cases these suggested amendments would make the USA provisions more consistent with the various federal rules applicable to sophisticated investors. Among other things these changes should reduce our industry's regulatory and compliance burden.

• Recommended Amendments:

1. Amend Section 102(11)(F) by striking "$25,000,000" and substituting in lieu thereof "$5,000,000".

2. Amend Section 102(11)(G) by striking "$25,000,000" and substituting in lieu thereof "$5,000,000".

3. Amend Section 102(11)(H) by striking "$25,000,000" and substituting in lieu thereof "$5,000,000"; and by striking the comma (,) following the word "assets", inserting a semicolon (;) in lieu thereof, and striking the remaining language beginning with the word "except".

4. Amend Section 102(11)(I) by striking "$25,000,000" and substituting in lieu thereof "$5,000,000".

5. Amend Section 102(11)(J) by striking "$25,000,000" and substituting in lieu thereof "$5,000,000".

6. Amend Section 102(11)(K) by striking "$25,000,000" and substituting in lieu thereof "$5,000,000".

7. Amend Section 102(11)(L) by striking the following language: "with investments under management in excess of $100 million".

8. Amend Section 102(11)(O) by striking "$25 million" and inserting in lieu thereof "$5,000,000".

Thank you for the opportunity to comment on this latest draft, and we shall appreciate your consideration of our views. Should you have questions, my contact information is shown below. I plan to be present at your April Committee meeting and may provide additional comments at that time.

Respectfully,

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