



July 16, 2007

Via E-mail

Ms. Jennifer J. Johnson  
Secretary  
Board of Governors of the Federal Reserve System  
20th Street and Constitution Avenue, NW  
Washington, D.C. 20551  
Attention: Docket No. R-1274

Ms. Nancy M. Morris  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, D.C. 20549-1090  
Attention: File No. S7-22-06

Re: Release No. 34-54946 (File No. S7-22-06): Proposed Regulation R

Ladies and Gentlemen:

The American Bankers Association (“ABA”) and its affiliate, the ABA Securities Association (“ABASA”), and The Clearing House Association L.L.C. (“The Clearing House”) are writing jointly to provide written responses to inquiries we have received from the staff of the Board of Governors of the Federal Reserve System (the “Board”) regarding Proposed Regulation R, which was proposed for comment by the Securities and Exchange Commission (the “Commission”, together with the Board, the “Agencies”) and the Board under the Securities Exchange Act of 1934 (the “Exchange Act”).<sup>1</sup> Regulation R would implement the bank exceptions to the definition of broker

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<sup>1</sup> Release No. 34-54946, 71 Fed. Reg. 77,522 (Dec. 26, 2006).

contained in Section 3(a)(4) of the Exchange Act, as amended by the Gramm-Leach-Bliley Act (the “GLBA”).

The Board staff’s inquiries related to matters raised in the initial comment letters on Proposed Regulation R filed by the ABA and ABASA (jointly) and by The Clearing House.<sup>2</sup>

#### I. Trust and Fiduciary Exception

The first set of questions we received related to the trust and fiduciary exception.

##### A. Foreign Branches of U.S. Banks

In light of our request that revenues from trust and fiduciary accounts maintained at foreign branches of U.S. banks be excluded from the bank-wide “chiefly compensated” test and in light of the fairly significant trust and fiduciary revenues that some U.S. banks report for their foreign offices on Schedule RC-T of the Call Report forms, we were asked how much of the business of foreign branches consists of activity that (but for the trust activities exemption) would require the bank to register as a broker under the Exchange Act (as opposed to trust and fiduciary activities of foreign branches that do not have a sufficient nexus to the United States to require the bank to register under the Exchange Act).

Banks responding indicated that line 19.a. of the Schedule RC-T captures fiduciary and related services income from foreign offices, including not only branches but also subsidiary banks and trust companies. Depending on the banking organization, the biggest single source of reported revenues may or may not be foreign branches of the U.S. bank. Nevertheless, banks believe that the number of trust and fiduciary customers served by foreign branches of U.S. banks who are U.S. residents or citizens is minimal. One large bank estimated that approximately eight percent of all fiduciary clients served by its foreign branches are either U.S. residents or citizens. Other banks thought that the percentage for their foreign branches was much lower or stated that the number of such accounts at their foreign branches is insignificant.

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<sup>2</sup> Letter from Sarah A. Miller, Director and Chief Regulatory Counsel, Center for Securities, Trust and Investments, American Bankers Association and General Counsel, ABA Securities Association, to Jennifer J. Johnson and Nancy M. Morris (March 26, 2007); Letter from Jeffrey P. Neubert, President and CEO, The Clearing House Association L.L.C. to Jennifer J. Johnson and Nancy M. Morris (March 30, 2007).

Banks believe that these U.S. resident or citizen customers are generally expatriates or U.S. persons who invest in different jurisdictions and use an overseas managed account to invest overseas. Accounts at foreign branches are subject to regulation and examination by the applicable U.S. banking regulators.

The Board staff also requested that we provide information regarding the ratio of fiduciary to total business conducted at foreign branches of U.S. banks. Although banks responding were unable to give precise information, they believed (with the exception of special purpose trust companies) that the trust and fiduciary business' contribution to the total business is small, because banks generally conducted their non-U.S. trust and fiduciary business outside the United States in separate foreign bank or trust company subsidiaries.

We were also asked whether the inclusion of revenues from foreign branches of U.S. banks in the calculation of the bank-wide chiefly compensated test would cause at least some banks to fall out of compliance with that test.

Responding banks generally were of the view that income earned from its foreign branch fiduciary operations would not cause the bank to fail the chiefly compensated test. Banks believe, however, that tracking revenue from foreign branch accounts for purposes of the chiefly compensated test would be extremely burdensome and would involve significant costs. We believe that those costs and burdens would far exceed any possible benefit of doing so. Therefore, we believe it is preferable to exempt foreign branch operations from the chiefly compensated test.

#### B. The Chiefly Compensated Test

We were asked several questions about the treatment of different types of revenues under the chiefly compensated test.

First, we were asked about the comment that monies earned by bank trust departments for providing certain services to affiliated and unaffiliated companies (e.g., mutual fund and other pooled fund advisory services, and fees for licensing asset management models) should not be counted in the chiefly compensated test. Specifically, we were asked what sort of products and services were involved, and what kinds of fees do bank trust departments receive for providing those products and services.

Upon further discussion, banks agreed that fees earned for providing investment advice or administrative services to a mutual fund or other pooled investment vehicle should be included as relationship compensation in the chiefly compensated test because those fees represent assets under management fees or administrative fees.

However, to the extent that fees solely for licensing asset management models to third parties are unrelated to providing investment advisory, administrative or other fiduciary services to a fiduciary account and may represent miscellaneous income to the trust and fiduciary business and thus may be included in the RC-T line 18 (other fiduciary and related service income) as income, such fees should not be included in the calculation of the bank-wide chiefly compensated test.

It should further be pointed out, that the issue of revenue derived from licensing investment models was raised in some bank comment letters as merely illustrative of the broader problem of referring in Proposed Rule 722(c) (the bank-wide chiefly compensated test) to the trust and fiduciary business whether or not associated with a trust or fiduciary account or an account at all. Numerous other examples could be provided. Modifying the language of Proposed Rule 722(c) would effectively resolve the issue of non-trust or fiduciary account related income being included in the test, both in this instance and a number of others.

Second, we were asked about the requests in the ABA/ABASA and The Clearing House letters that fees that banks receive for settling securities transactions for trust or fiduciary accounts should not be subject to the statutory limit applicable to a “flat or capped per order processing fee . . . in connection with executing securities transactions.” We were asked how these fees are structured, whether they are earned by the trust department or the custody department, whether they vary depending on the price or quantity of the securities, and whether banks would fail the chiefly compensated tests if these fees are treated as sales compensation.

Many banks operate their custody business within the same department as their trust and fiduciary business. Banks reported that it was not uncommon for directed trust accounts, as well as custody accounts, to be assessed a settlement fee each time the bank has to settle a securities transaction. Banks noted that the settlement fees are assessed regardless of whether the settlement instructions came from the client’s broker or directly from the client or its investment adviser.

Settlement fees are generally structured as flat dollar fees with no differentiation on the basis of the number of shares involved or the dollar value of the trade. Fees could vary based on whether the security is publicly traded or privately held, whether the trade is international or domestic, or whether the settlement is by book-entry or is physical. Another factor that could cause some variation in the settlement fee assessed might be whether the security was DTC eligible for straight through processing.

Banks expressed different views on the issue of whether the way settlement fees for trust or fiduciary accounts are treated would make a difference for

purposes of the chiefly compensated test. Generally, banks opined that the percentage of fees earned from settlement fees were relatively small and would not cause their institutions to fail the chiefly compensated test when conducted on a bank-wide basis. A number of banks pointed out, however, that the treatment of such fees could create an issue when and if a bank has to conduct the test on an account-by-account basis.

Banks believe that settlement fees, if charged by a bank trust department, are administrative fees rather than “per order processing fees for execution.” The GLBA distinguishes between execution, which a bank acting in a fiduciary capacity must conduct through a registered broker-dealer except in certain circumstances, and settlement, which is a permitted activity. Under the statute, the limit on per order processing fees is applicable only when a bank is “executing securities transactions.” If settling a securities transaction were deemed to be executing, then Section 3(a)(4)(C) would preclude banks from settling securities transactions, which it clearly does not do.

Banks also pointed out that imposing such a limit on settlement fees would create an anomaly under the statute, because a bank that handled settlement through a custody account would not be subject to limitations on the settlement fees it charges while if the bank handled settlement through a trust or fiduciary account, the bank would be subject to limitations.

Finally, it was noted that banks also charge for memo entries (securities held elsewhere), corporate actions, proxy voting, as well as income receipts and disbursements. As with settlement fees, these fees are administrative fees and do not vary based upon whether the instruction comes from the customer, its investment manager or its broker-dealer.

Third, we were asked how bank trust departments structure the fees that they charge for determining whether the account is being managed in compliance with legal or other requirements, including whether an investment manager is in compliance with its investment guidelines. In the case of the latter, a set of guidelines is created for each manager, then investments are compared to the guidelines and the client is notified if a manager is out of compliance.

Compliance monitoring fees are based on a number of accounts to be monitored and the frequency of the monitoring (i.e., daily, monthly, quarterly, etc). Banks generally indicated that compliance fees were generally charged for monitoring an account on an annual basis, paid quarterly. Accordingly, we believe that the fees constitute “an administrative or annual fee” and so qualify as relationship compensation. Compliance fees generally are not priced as a percentage of assets under management.

C. Bank IRA Trustee Activities

We were asked about the request in the ABA/ABASA letter that banks that serve as an IRA trustee not have to comply with the trust and fiduciary exception if the assets in the IRA account are held at a clearing broker. (Page 21) This request was made because some banks were concerned that because they did not have trust powers, they could not satisfy the statutory requirements to be “regularly examined by banks examiners for compliance with fiduciary principles and standards.” Specifically, we were asked if the banks’ concerns could be addressed if the bank regulators revised their safety and soundness exams to require examinations of such banks to cover such principles and standards.

Affected banks responded that their concerns could be addressed if the regulators safety and soundness examinations were so revised.

II. Safekeeping and Custody Exception

A. Services to Other Banks and Institutions

We were asked several questions about the request (page 23 in ABA/ABASA letter) that bank custody departments be able to rely on the exemption in Proposed Rule 760(a) (which currently allows order taking for employee benefit plan and IRA accounts) when taking orders forwarded by the trust or custody departments of other banks.

First, we were asked if banks need this solely for employee benefit plan accounts and IRA accounts of other custodian banks, or also for other types of accounts of other banks.

Second, we were asked whether a bank custody department would be able to tell what type of customer gave the other bank the order (i.e., would a bank custody department be able to tell whether the order came from an employee benefit or IRA account at another bank?).

Third, we were asked what the problem was for banks with having to comply with the limitations in Proposed Rule 760(b) (the “accommodation” exemption) rather than with Proposed Rule 760(a).

Fourth, we were asked whether banks, acting in either a custodial capacity or as non-fiduciary administrator or recordkeeper for employee benefit plans, ever

effected cross trade orders between plans of which different third parties are the trustees and, if such banks were precluded from doing so, whether this would be a problem.

Frequently, banks that provide this custodial service do so on an omnibus basis for an unaffiliated bank or trust company in order to provide cost efficiencies for both parties. For most banks, the majority of these accounts are employee benefit trust and other accounts for which the third-party bank or trust company may be acting in either a fiduciary or custodial role that is generally unknown to the custodial bank. The third-party bank or trust company that uses the custodial bank's trade order handling system is a custody customer of the custodian bank. The third-party bank or trust company communicates all orders to the custodian bank; the custodian bank never accepts orders directly from the third-party bank's client. While the custodial bank cannot be certain what type of accounts it is holding on an omnibus basis, it, nevertheless, generally obtains representations and warranties from the third-party bank regarding the types of accounts for which the custodial bank's services are being provided.

While the intent of these banks is to grow this omnibus custodial business and the intent of the third-party banks is generally to obtain cost efficiencies by outsourcing these services on an omnibus basis, these banks may, upon request of the third-party bank, serve as a back-office custodian for the third-party bank and its customers on an individual account basis, and thus the custodial bank would be able to distinguish the type of customer. Even in these cases, however, the custodian bank never accepts an order directly from a customer of the third-party bank or trust company.

Other banks specifically market themselves as providing back-office custodial services for third-party banks and trust companies. Because these services are either not offered on an omnibus basis or because the custodian bank provides sub-custody services, the custodial bank generally will know whether the third-party bank's clients are personal or institutional. As above, however, the custodian bank never accepts an order directly from the customer of the third-party bank or trust company.

One bank noted that although the bulk of its custodial business involves employee benefit accounts with investment options that are limited to mutual funds and employer stock, this bank cannot fit within the accommodation exemption of Proposed Rule 760 because it charges fees that vary based on the quantity of the employer stock involved in the transaction. Other banks cannot comply with the accommodation exemption because they provide investment research, on both a complimentary or a paid basis, to their third-party bank and trust company clients.

Again banks acting in a custodial capacity with respect to other third-party institutions do not take orders from the plans themselves, but rather from the third-party

institutions. These institutions may aggregate or net mutual fund transactions across their client base before submitting the omnibus order to the custodial bank. The custodial bank, in turn, may also net mutual fund transactions across its client base. Netting provides cost efficiencies for the custodial bank's customers, and the underlying plans and plan participants, and should not be discouraged.

We therefore continue to believe that, in those situations when a bank serves as custodian for a third-party bank or trust company, the bank should be able to rely on the exemption in Proposed Rule 760(a).

B. Escrow Agent and Issuing and Paying Agent Accounts

We were asked why banks requested the ability to rely on Proposed Rule 760(a) to take orders for escrow accounts and issuing and paying agency accounts.

The ability to rely on Proposed Rule 760(a) would provide banks with needed flexibility in servicing these accounts.

C. Servicing Accounts

In reviewing Proposed Rule 760 in connection with the questions stated above, we have become concerned that Proposed Rule 760(d) might be interpreted in a manner inconsistent with what we believe was the Agencies' intent. The mere fact that a bank is named as a "trustee" for an account should not, in our view, prevent it from relying on Proposed Rule 760 to provide services to the account if all of the services are permitted custody services and the bank otherwise complies with Proposed Rule 760. Yet Proposed Rule 760(d) states that a bank may accept orders for an account to which it provides custody services only if the bank "does not act in a trustee or fiduciary capacity ... with respect to the account." We are concerned that if a bank is a named "trustee," it may be deemed for these purposes to "act in a trustee ... capacity ... with respect to the account."

We recognized, of course, that a bank may not provide services to an account pursuant to the trust and fiduciary exception in the statute, or one of the rules implementing that exception, and then provide order taking to the same account beyond what is permitted under the trust and fiduciary exception on the theory that it is providing order taking under Proposed Rule 760 and fiduciary services pursuant to the trust and fiduciary exception. The language of Proposed Rule 760(d), however, would appear to go further than that.



Board of Governors of the Federal Reserve System  
Securities and Exchange Commission

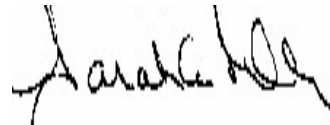
-9-

We respectfully request that the Agencies consider the issues set forth above. Please contact either of us should you wish to discuss these matters.

Sincerely,



Norman R. Nelson  
General Counsel  
The Clearing House Association L.L.C.



Sarah A. Miller  
Director & Chief Regulatory Counsel  
Center for Securities, Trust  
and Investments  
American Bankers Association and  
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