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June 18, 2007

Nancy M. Morris
Secretary
U.S. Securities and Exchange Commission
100 F. Street, N.E.
Washington, D.C. 20549-1090
Rule-Comments@sec.gov

Re: Amendments to Financial Responsibility Rules for Broker-Dealers; Release No. 34-55431; File No. S7-08-07; 72 Fed. Reg. 12862 (March 19, 2007).

Dear Ms. Morris:

The PNC Financial Services Group, Inc. ("PNC"), and its principal subsidiary bank, PNC Bank, National Association ("PNC Bank"), both of Pittsburgh, Pennsylvania, appreciate the opportunity to comment on the Securities and Exchange Commission's ("Commission") proposed amendments to the broker-dealer financial responsibility rules ("Proposal"). Under Rule 15c3-3, broker-dealers must maintain segregated customer funds in such a manner that those assets are protected in case of broker-dealer insolvency (hereinafter referred to as "Special Reserve Accounts").

PNC is one of the largest diversified financial services companies in the United States, with $122.6 billion in assets as of March 31, 2007. PNC engages in retail banking, institutional banking, asset management and global fund processing services. Its principal subsidiary bank, PNC Bank, has branches in the District of Columbia, Florida, Indiana, Kentucky, Maryland, New Jersey, Ohio, Pennsylvania and Virginia. PNC also has 12 other subsidiary banks, which are located, and/or have branches in, Delaware, Maryland, Pennsylvania and Virginia.

PNC also has several broker-dealer affiliates, including J.J.B. Hilliard, W.L. Lyons, Inc., which is a member of the National Association of Securities Dealers ("NASD") and the New York Stock Exchange, and PNC Investments, LLC, PNC Capital Markets, Inc., and Mercantile Brokerage Services, Inc., all of which are members of the NASD.

PNC is quite concerned about two aspects of the Proposal: (1) the restriction on the ability of a broker-dealer to maintain with a bank Special Reserve Accounts that, in the aggregate, exceed ten percent of the bank's equity capital and (2) the prohibition on a broker-dealer being able to maintain Special Reserve Accounts with an affiliated bank. PNC believes that the brief explanation for these restrictions set forth in the preamble to

the Proposal ignores the comprehensive regulatory and supervisory regime in place for insured depository institutions as well as the statutory and regulatory restrictions in place with respect to transactions between an insured depository institution and its affiliates, including its broker-dealer affiliates.

The Ten Percent Restriction

While the Commission does not set forth in the Federal Register notice the origin of its proposed regulations, the ten percent of bank capital restriction would appear to be derived from a 1988 Commission staff letter to the New York Stock Exchange, which states that Special Reserve Accounts may be maintained in money market deposit accounts, as defined in Regulation D (12 C.F.R. § 204) promulgated by the Board of Governors of the Federal Reserve System ("Board"), provided that the total of such deposits with any one bank does not exceed 50 percent of the broker-dealer's excess net capital or ten percent of the bank's equity capital.[1] This interpretive letter did not contain any analysis to support the adoption of this restriction.

Regardless of the rationale for establishing such a restriction in 1988, there seems to be little reason to perpetuate such a restriction, given the significant changes that have taken place with respect to federal bank regulatory agency oversight of the safety and soundness of banks since that time. Specifically, in 1991, Congress passed the Federal Deposit Insurance Corporation Improvement Act ("FDICIA"),[2] which includes prompt corrective provisions requiring the federal bank regulatory agencies to establish regulatory capital requirements for banks. Furthermore, the bank regulatory agencies instituted a system for assessing the capital adequacy of banks, and they are required to take supervisory action in the event a bank is deemed not to be adequately capitalized. Banks that experience deterioration in their capital levels are compelled by their Federal bank supervisors to take prompt action to correct the capital deficiency. Accordingly, the concerns that gave rise to the Commission Staff's 1988 letter, and those expressed in the Proposal, have been mitigated by statutes and regulations requiring prompt corrective action in the event a bank's capital position deteriorates.[3]

It should also be noted that a bank's capital category, on which prompt corrective action directives are based, is easily derived from publicly available information that is published on a quarterly basis by a bank in its Report of Condition (or Call Report). The Federal Financial Interagency Examination Council ("FFIEC") posts the Call Report for each insured financial institution on its website. Accordingly, this information is available to the general public, including broker-dealers. In addition, the prompt corrective action regulations of each of the federal bank regulators require a bank to

[1] SEC Staff to NYSE, No. 88-1 (February 1988).
[2] 12 U.S.C. § 1831o.
[3] See, for example, 12 C.F.R. § 6, the prompt corrective actions regulations of the Office of the Comptroller of the Currency, Each of the federal bank regulators has virtually identical regulations.

provide its primary federal bank regulator with written notice of any downward adjustment to the bank's capital category within 15 calendar days of the date of any material event that would cause the bank to be placed in a lower capital category.[4]

There are a number of consequences that befall an insured depository institution that falls out of the well capitalized category. For example, while a well capitalized bank may accept broker deposits, a bank that is only adequately capitalized requires the approval of the Federal Deposit Insurance Corporation before it may accept brokered deposits.[5] Also, if the bank is the subsidiary of a "financial holding company" that may engage in a broader range of financial activities than was permitted for a bank holding company before the passage of the Gramm-Leach-Bliley Act, that company will become subject to an order requiring the company to cease engaging in activities on the basis of its financial holding company status if the bank does not become well-capitalized within 180 days.[6] The bottom line is that it is extremely important for a bank to maintain its well capitalized status, and loss of that status can quickly become a well-publicized event.[7]

Prohibition on Maintaining Special Reserve Accounts with an Affiliated Bank

With respect to the prohibition on a broker-dealer maintaining a Special Reserve Account with an affiliated bank, the Proposal also fails to take into consideration the very stringent restrictions on transactions between a bank and its affiliates, including its broker-dealer affiliates, by Section 23B of the Federal Reserve Act and the Board's Regulation W (12 C.F.R. § 223).[8] In essence, the statute and the regulation require that any bank transaction with an affiliate must be made "on terms and under circumstances ... that are substantially the same, or at least as favorable to such bank or subsidiary, as those prevailing at the time for comparable transactions with or involving other nonaffiliated companies."[9] Consequently, bank holding companies and their subsidiary banks make great efforts to ensure that these transactions take place on an arm's-length basis. The

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[4] See, for example, 12 C.F.R. § 6.3(c).
[5] 12 C.F.R. § 337.6(b).
[5] 12 U.S.C. § 1831f.
[6] See, for example, 12 C.F.R. § 5.39(j).
[7] In most cases, the bank's holding company, if it were publicly held, would have to publish a Form 8-K noting the change in capital category, as it could have a material impact on the holding company and its activities.
[8] In most bank holding companies, the principal broker-dealer is a bank "affiliate," in that it is held as a bank holding company, rather than a bank, subsidiary. (For the purposes of Section 23B, a subsidiary of a bank generally is not an "affiliate" of the bank. See 12 U.S.C. § 371c-1(d)(1)). It should be noted, however, that a broker-dealer that is a bank subsidiary would be deemed an "affiliate" of the bank if it engages in securities underwriting and dealing, in addition to securities brokerage, activities. Such a securities subsidiary would be a "financial subsidiary" pursuant to the Gramm-Leach-Bliley Act. See 12 C.F.R. §§ 5.39(e)(1)(v) and (h)(5).
[9] 12 U.S.C. § 371c-1(a)(1)(A).

bank regulators examine banks regularly for section 23B compliance, and violations of this statute and Regulation W are considered to be extremely serious.

The Commission does not mention Section 23B in its proposal, but rather assumes that "the risk might be heightened when the deposit is held at an affiliated bank in that the broker-dealer may not exercise due diligence with the same degree of impartiality when assessing the financial soundness of an affiliate bank as it would with a non-affiliate bank."[10] We contend, however, that because of the importance of compliance with Section 23B, a deposit held at an affiliated bank would in fact receive heightened due diligence by both the broker-dealer and its affiliated bank.

Recommendation

In the Commission's comment on transactions with an affiliated bank cited above, the Proposal refers to the "due diligence" performed by the broker-dealer on the bank where it holds Special Reserve Accounts. This is the only reference to broker-dealer due diligence in the entire proposal. The reliance on arbitrary percentages of bank capital limitations and a prohibition on transactions with affiliated banks could lead broker-dealers to believe that conforming to these limitations is a substitute for the responsibility to perform due diligence on the banking organizations with whom Special Reserve Accounts are maintained.

Given the amount of information that is available on a real-time basis regarding the capital adequacy and other aspects of a banking institution's financial and managerial strength, we believe that a far superior approach to determining where Special Reserve Accounts may be maintained would be to have broker-dealers rely on their performance of due diligence. In addition, the deposit contract between the broker-dealer and the bank where it holds the Special Reserve Account could require the bank to notify the broker-dealer if its risk-based capital falls below the "well capitalized" or "adequately capitalized" category. On this basis, the broker dealer could determine whether and to what extent it should maintain Special Reserve Accounts with a particular bank, including an affiliated bank.

Conclusion

We strongly recommend that the Commission revise its Proposal to permit a broker-dealer to maintain Special Reserve Accounts with a bank, including an affiliated bank, on the basis of the due diligence that the broker-dealer performs on that bank. We believe that arbitrary percentage of capital restrictions, and a prohibition on maintaining Special Reserve Accounts with an affiliated bank, unnecessarily restricts a broker-dealer in making a determination with respect to placing Special Reserve Accounts, without

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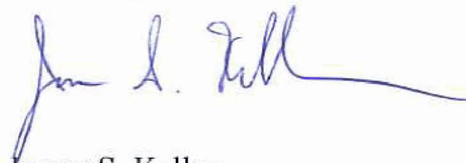
[10] 72 Fed. Reg. at 12864.

necessarily furthering, and possibly undermining, the Commission's objectives as expressed in the Proposal.

If you would like to discuss any aspect of this letter, please do not hesitate to call me.

Sincerely,



James S. Keller

cc: Gary TeKolste
Office of the Comptroller of the Currency

Michael F.Carroll
Federal Reserve Bank of Cleveland

Kathleen A. Flannery
The PNC Financial Services Group, Inc.