March 26, 2007

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Ms. Nancy M. Morris
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Regulation R - Definitions of Terms and Exemptions Relating to the "Broker" Exceptions for Banks; Docket No. R-1274; File Number S7-22-06; 71 FR 77522 (December 26, 2006)

Dear Ms. Johnson and Ms. Morris:

America's Community Bankers [1]("ACB") is pleased to comment on proposed Regulation R that would implement certain exceptions for banks[2] from the definition of the term "broker" under Section 3(a)(4) of the Securities Exchange Act of 1934 ("Exchange Act"), as amended by the Gramm-Leach-Bliley Act ("GLB Act").

The GLB Act excepted from the broker registration requirements of the Exchange Act certain traditional banking activities that involve securities products or securities transactions. Jointly issued by the Board of Governors of the Federal Reserve System ("FRB") and the Securities and Exchange Commission ("SEC"), as required by the Financial Services Regulatory Relief Act of 2006 ("Regulatory Relief Act"), proposed Regulation R would define terms and set the parameters for certain of the GLB Act statutory exceptions. The provisions of proposed Regulation R apply to the following: third-party networking arrangements, trust and fiduciary activities, sweep and money market account activities, and safekeeping and custody activities. Proposed Regulation R is very important to community banks that conduct the GLB Act excepted activities.

[1] America's Community Bankers is the national trade association committed to shaping the future of banking by being the innovative industry leader strengthening the competitive position of community banks. To learn more about ACB, visit www.AmericasCommunityBankers.com.

[2] The Financial Services Regulatory Relief Act of 2006 gave savings associations parity with banks under the Securities Exchange Act of 1934.

ACB Position

ACB applauds the efforts of the FRB and the SEC to propose a workable regulation to interpret and implement the GLB Act exceptions. Proposed Regulation R is a substantial improvement over the SEC's proposed Regulation B, which will be superseded by final Regulation R. We believe that proposed Regulation R is a more flexible and workable rule for banks and savings associations because the FRB and the SEC have considered industry comments on the Regulation B proposals and have now taken into account how banks and savings associations conduct traditional trust and fiduciary activities for their customers. However, we believe that additional clarification is necessary where the proposal does not consider current banking law and bank practices as to particular excepted activities. ACB strongly recommends the final rule does the following:

1) Explicitly state that banks may continue to conduct the GLB Act exceptions in a financial or operating subsidiary as authorized under banking law without broker-dealer registration;
2) Reduce the institutional and high net worth customer eligibility requirements in the networking exception provision;
3) Revise the threshold percentage of the bank-wide test to not more than 60 percent for the determination of the "chiefly compensated" condition under the trust and fiduciary exception and permit the exclusion of de minimus accounts each year;
4) Clarify certain definitions to correspond to how trust and custodian accounts are maintained by banks; and
5) Continue the authority of the SEC's Director of the Division of Market Regulation to exempt individual banks and savings associations from the broker-dealer registration requirements on a case-by-case basis.

Background

The Regulatory Relief Act specifically gave savings associations parity with banks under the Exchange Act. The Regulatory Relief Act added to the definition of "bank" savings associations, both federally chartered and state chartered with deposits insured by the Federal Deposit Insurance Corporation. Therefore, savings associations are considered banks for the purposes of the Exchange Act and will receive the same treatment as banks under the Exchange Act, which includes the GLB Act exceptions and SEC regulations implementing the exceptions. The Regulatory Relief Act also added to the Exchange Act the Office of Thrift Supervision ("OTS") to the definition of an "appropriate regulatory agency." Throughout the remainder of this comment letter, the term bank includes in all instances savings associations as defined above unless otherwise noted.

The excepted activities subject to proposed Regulation R are activities that banks have traditionally engaged in without broker-dealer registration for many years prior to the enactment of the GLB Act. Banks have continued to engage in these activities after

enactment of the GLB Act without the SEC implementing regulations but in accordance with the SEC's temporary exemptions. It is important to recognize that banks have been conducting these activities under banking law and the supervision of the bank regulatory agencies without harm to investors. ACB strongly believes that banks should be permitted to continue these traditional activities for their customers as they have done so in the past and without undue regulatory burden, administrative burden, and costs.

Bank Financial and Operating Subsidiaries

Although banks most often conduct the excepted activities within the bank itself, some banks have opted, as permitted under banking law, to conduct the excepted activities in a financial or operating subsidiary. Section 24a of the National Bank Act authorizes banks to conduct certain activities that are financial in nature and that are permitted for national banks to engage in directly.[3] From this statutory authority, the Office of the Comptroller of the Currency ("OCC") adopted regulations governing financial and operating subsidiaries. Likewise, the OTS permits federal savings associations to establish operating subsidiaries based on its rulemaking and supervisory authority under the Home Owners' Loan Act ("HOLA")[4] and specific authority under section 18(m) of the Federal Deposit Insurance Act.[5]

Operating subsidiaries are defined as corporations that are controlled by the parent bank and that may only engage in the same activities that are specifically permissible for the parent bank. The activities of an operating subsidiary are subject to examination and supervision by the OCC and OTS to the same extent as the parent bank. Operating subsidiaries provide banks with flexibility in structuring and managing their operations and banks have established operating subsidiaries to conduct the GLB Act excepted activities. ACB strongly believes that Regulation R should clarify that it is permissible for banks to conduct the GLB Act excepted activities in financial and operating subsidiaries to the same extent as the parent bank without broker-dealer registration.

Networking Exception

ACB believes that the proposed Regulation R referral and compensation provisions under a networking arrangement with a broker-dealer are an improvement over the Regulation B proposals. Regulation R provides a bank greater flexibility to structure networking compensation programs by providing three alternatives for calculating "nominal" referral fees. It is not clear, however, whether a bank must select only one of the three alternatives of calculating referral fees or whether a bank could apply different alternatives to different "job families," as that term is defined in the proposed rule, within the bank. In addition, it is not clear in the proposal that the bank pays the referral fee and

[3] 12 U.S.C. 24 and 24 (a).
[4] 12 U.S.C. 1462 et seq.
[5] 12 U.S.C. 1828 (m).

not the broker-dealer. We believe the networking provisions should be clarified on these issues.

In addition, we support the provision in proposed Regulation R that permits a bank to pay to a bank employee a referral fee of more than a nominal amount for referring an "institutional" or "high net worth" customer, with which the bank has an existing relationship, to a broker-dealer. It is important for a bank to be able to pay an adequate fee for such referrals. The Regulation R proposal defines an "institutional customer" as a corporate entity that has at least $10 million in investments or $40 million in assets. Proposed Regulation R permits a lower threshold of $25 million in assets if the bank employee refers the customer to the broker-dealer for investment banking services. A "high net worth customer" is defined as a natural person who has at least $5 million in net worth excluding the primary residence.

ACB believes that the institutional and high net worth customer eligibility requirements are too high to meet the intended purpose of the exception. The proposed Regulation R requirements are much more stringent than other criteria used by the SEC to determine investor suitability. We believe that these thresholds should be revised to correspond to the more reasonable thresholds established by the SEC in its Regulation D, which provides a safe harbor for non-public offerings of securities.[6] For example, an accredited investor is defined as a corporate entity with $5 million in assets or a natural person with a net worth that exceeds $1 million. Regulation D also considers a natural person to be an accredited investor if that person has an individual income of $200,000 in each of the two most recent years or joint income with that person's spouse of $300,000 in each of those years.

The Regulation D accredited investor thresholds are significantly below those proposed in Regulation R and are much more sensible. SEC regulations should be consistent, and we see no reason why similar thresholds should not be used in Regulation R. This is particularly true given that mere referrals of bank customers to a registered broker-dealer would certainly raise no greater investor protection issues than those raised in a private placement of securities under Regulation D. It is also important to recognize that an institutional investor does not have the same suitability concerns as an individual investor. The proposed Regulation R definitions will unreasonably limit the number of bank referrals of institutional and high net worth customers that will be eligible for the higher fee under this GLB Act exception.

[6] 17 C.F.R. § 230.501(a) (3).

Trust and Fiduciary Exception

Chiefly Compensated

ACB supports the Regulation R proposal that offers an account-by-account approach and a bank-wide approach to determine the GLB Act "chiefly compensated" condition in the trust and fiduciary exception. However, we urge the FRB and the SEC to re-consider the percentage threshold for the bank-wide approach. The account-by-account approach provides that a bank would meet the "chiefly compensated" test if the relationship compensation is more than 50 percent for each account. Conversely, the bank-wide approach requires greater than 70 percent of total compensation from trust and fiduciary accounts to meet the "chiefly compensated" test. We do not know why the FRB and SEC chose 70 percent as the threshold. We believe that the 70 percent is too high and is not justified. Banks need more flexibility to accommodate changes in trust operations and economic fluctuations. We believe that the bank wide approach threshold should be lowered to not more than 60 percent in the final rule.

In addition, it is not clear from the proposal why banks complying with the "chiefly compensated" test of the trust and fiduciary activity exception are only permitted to exclude de minimus accounts from the calculation every other year and not consecutively. We see no reason why de minimus accounts, as defined in the proposed rule, should not be excluded each year. This small number of accounts should not present a risk that a bank is operating as a securities broker in its trust department, and excluding these accounts on an annual basis should reduce administrative burdens.

Trust or Other Department

The GLB Act trust and fiduciary activities exception requires that a bank conduct these transactions in a trust department or other department of the bank that is regularly examined by bank examiners for compliance with fiduciary principles and standards. Section 1464(n) of HOLA[7] governs trusts of federal savings associations and that section does not require a savings association to maintain a separate department for trust activities. Instead, the savings association acting in a fiduciary capacity is required to segregate assets from the general assets of the association and keep a separate set of books and records showing in detail the transactions engaged in by the association. Similar provisions apply to national banks under the rules and regulations of the OCC.[8]

Furthermore under HOLA, federal savings associations may act as trustees of stock bonus, pension, profit sharing plans qualifying for special tax treatment under Internal Revenue Code section 401(d) and individual retirement accounts ("IRAs") under Internal

[7] 12 U.S.C. §1464 (n).
[8] 12 C.F.R. § 9.8 and § 9.13.

Revenue Code section 408 (a).[9] Funds in these accounts are only permitted to be invested in deposits, securities or obligations of the savings association.[10] Because these are long established bank products with restricted investment options, these accounts are usually not offered through a separate trust or other department of the bank. Nevertheless, these accounts continue to be examined for compliance with sound fiduciary principles by bank examiners. Therefore, we request that the FRB and SEC clarify that compliance with segregation standards imposed by banking law in effect meet the GLB Act requirements for this exception.

Safekeeping and Custody

The safekeeping and custody exception could be used as an alternative to the trust and fiduciary exception for employee benefit plans and IRAs. ACB however is concerned that the safekeeping and custody exception of proposed Regulation R will not be available for banks for the following reasons. As proposed, a bank designated as a trustee of these accounts would be considered to be acting in a fiduciary capacity under Regulation R. Banks as trustees of these plans are considered fiduciaries only for the purpose of holding the plans' assets but have no investment discretion. Although a bank is designated as a "trustee" for a plan, the bank does not act in a fiduciary capacity but rather in a "custodian" capacity. We do not believe that the GLB Act limits the use of this exception for these accounts. We strongly recommend that the FRB and SEC clarify in the final rule that, although IRAs are titled in a bank's name as trustee of the account, banks act in the capacity of a custodian of the account and should be covered by the safekeeping and custody activities exception.

Division of Market Regulation Exemption

The SEC's proposed Regulation B included a provision that amended the SEC's Rules of Organization and Program Management and delegate authority to the Director of the Division of Market Regulation to consider requests from individual banks for exemptive relief from the broker registration requirements. We are concerned that by operation of the Regulatory Relief Act, Regulation B will be superseded by Regulation R and this provision for exemptive relief also will be superseded. We request that the SEC clarify that this delegated authority to the Director of the Division of Market Regulation will continue after Regulation R is finalized. If not, ACB strongly recommends that this same provision for exemptive authority be included in the final Regulation R.

Prior to the enactment of the GLB Act, banks were permitted to conduct many securities activities without broker-dealer registration. Banks may have specific considerations or developed methods to conduct these activities that may be unique to that bank. Individual banks should be able to submit requests for exemptive relief to the SEC. The

[9] 26 U.S.C. 401(d) and 26 U.S.C. 408(a).
[10] 12 U.S.C. §1464 (l).

SEC should have the flexibility to grant relief on a case-by-case basis after considering the facts and circumstances of individual cases.

Conclusion

ACB appreciates the opportunity to comment on this important matter for community banks. We are available to assist the FRB and SEC in formulating a rule that recognizes how banks conduct their business. If you have any questions, please contact Patty Milon at (202) 857-3121 or pmilon@acbankers.org or the undersigned at (202) 857-3186 or shaeger@acbankers.org.

Sincerely,

Sharon A. Haeger
Regulatory Counsel