AMERICAN BANKERS ASSOCIATION

1120 Connecticut Avenue, NW
Washington, DC 20036

1-800-BANKERS
www.aba.com

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Sarah A. Miller
Director
Center for Securities, Trust and Investments
202-663-5325
202-828-4548
Smiller@aba.com

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Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-0609

Re: Proposal to Except Certain Thrift Institutions from Investment Adviser Registration, File No. S7-20-04, 69 Federal Register 25778 (May 7, 2004).

Dear Mr. Katz:

The American Bankers Association ("ABA") appreciates the opportunity to offer its views on the proposal issued by the Securities and Exchange Commission ("Commission) to except, under certain circumstances, savings associations from investment adviser registration. This proposal is very important to both ABA's savings association members and those bank holding company members with savings association subsidiaries.[1] As the Commission is aware, the ABA has long championed the notion that savings associations should be exempt from investment adviser registration under the Investment Advisers Act to the same extent as commercial banks and trust companies.[2] And while the ABA welcomes what the Commission has proposed, the proposal, unfortunately, falls far short of achieving parity for savings associations. The ABA strongly encourages the Commission to revise its proposal and except fully savings association trust activities from investment adviser registration.

Proposed Rule 202(a)(11)-2 would except a savings association from investment adviser registration to the extent that the institution provides investment advice in its capacity as trustee, executor, administrator or guardian. To the extent a savings association provides investment advice in any other fiduciary capacity, however, it would not be excepted from investment adviser registration.

[1] 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—make ABA the largest banking trade association in the country.

[2] See Testimony of Elizabeth A. Duke on behalf of the ABA before the Subcommittee on Financial Institutions and Consumer Credit of the Financial Institutions Committee, United States House of Representatives, 107th Cong., 2nd Sess. April 25, 2002.

The proposal would also except a savings association from investment adviser registration to the extent it provides advisory services to collective investment funds. Collective investment funds are pooled funds used by banks and savings associations to manage qualified and government plans that are exempt from registration under the Investment Company Act of 1940.[3] Finally, the proposal would also except savings associations from investment adviser registration with respect to accounts invested solely in one or more of the savings association's sponsored collective trust funds.

The Commission offers the following reasons for not granting savings associations full parity with commercial banks and trust companies:

- A general exception is inconsistent with functional regulation principles.

- A general exception would create regulatory disparity between those registered investment advisers offering retail investment advisory services and savings associations offering these same services and could result in many integrated financial services firms moving regular advisory activities to their captive savings associations in order to escape regulation under the Investment Advisers Act.

- A general exception would eliminate important investor protections afforded to advisory clients under the Investment Advisers Act.

The ABA respectfully suggests that the reasons given by the Commission for failing to grant savings associations full parity with commercial banks and trust companies do not hold up under a closer examination.

DISCUSSION

<u>A Full Exception from Investment Adviser Registration is Consistent with Functional Regulation.</u>

The exemption from investment adviser registration for commercial banks and trust companies (hereinafter referred to as "bank" or "banks") is grounded upon the notion that bank trust departments that provide investment advice to personal trust accounts, charitable foundations, employee benefit plans, and the like are subject to federal and state fiduciary laws and are appropriately regulated and supervised by state and federal banking regulators. Savings associations, like their commercial bank brethren, are subject to a multitude of state and federal fiduciary laws, including ERISA, rules and regulations issued by their primary regulator, state fiduciary law, and decisional law and are subject to extensive examination and oversight by federal and state regulators.

In 1980, the Congress, when it authorized savings associations to engage in trust and fiduciary activities on the same basis as national banks, did not provide savings associations with an exemption from investment adviser registration commensurate

[3] Section 3(c)(11) of the Investment Company Act of 1940, 15 USC 80a-3(c)(11).

with that provided by the Congress forty years earlier for banks. The lack of a Congressionally provided exemption cannot and should not be read as suggesting that the 96th Congress recognized that investment adviser registration for savings associations was appropriate. Instead, the lack of an adviser exemption for savings association should be recognized for what it is: an unfortunate oversight on the part of the drafters of that 1980 legislation.[4]

The Commission, however, has the power to rectify this situation under its exemptive authority and we would strongly encourage them to do so. Granting a full exemption for savings associations would, we submit, be fully consistent with the principles of functional regulation articulated by the Congress in enacting the Gramm-Leach-Bliley Act ("GLBA").[5] As the Commission is well aware, the GLBA provided a statutory framework that would allow full affiliation between banks, securities firms and insurance companies through separate legal entities that would be functionally regulated by their primary regulator. Functional regulation contemplates that banking activities will be conducted in depository institutions subject to oversight by the bank regulators, while securities activities will be conducted in securities affiliates subject to oversight by the securities regulators.[6] Functional regulation does not contemplate duplicative regulation at the federal level.

Trust and fiduciary activities were one of several activities that the 106th Congress specifically determined to be traditional banking activities that should remain in the bank and not be subject to broker-dealer registration.[7] Specifically, GLBA provides that banks that act in either "a trustee capacity" or "a fiduciary capacity" are exempted from the definition of broker. "Fiduciary capacity" is defined to include trustee, executor, administrator, guardian, investment adviser if the bank receives a fee for its investment advice, and where the bank exercises investment discretion on behalf of another.

Similarly, in examining banks' exemption from investment adviser registration, the Congress chose only to require banks to register as investment advisers to the extent they advised registered mutual funds.[8] The Congress deliberately chose not to require banks to register as investment advisers when functioning in any other trustee or fiduciary capacity. We would submit that since the Congress determined that the principles of functional regulation supported exempting bank trust and fiduciary activities from both broker and investment adviser registration, the

[4] The Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132 (1980).

[5] Pub. L. No. 106-102, 113 Stat. 1339 (1999).

[6] See Section 111 of GLBA amending Section 5(c) of the Bank Holding Company Act.

[7] See e.g., Conf. Rep. 106-434, 106th Cong. 1st Sess. at 164 (1999); S. Rep. No. 106-44, 106th Cong. 1st Sess. at 10 (1999).

[8] GLBA amended the Investment Advisers Act to provide that commercial banks must register as investment advisers to the extent they provide investment advice to *registered* investment companies. See Section 217(a) of the GLBA amending Section 202(a)(11)(A) of the Investment Advisers Act. All other investment advisory activities conducted in the bank would continue to be exempt from registration under the Investment Advisers Act.

Commission should follow the Congress' lead and exempt savings associations that act in a trust or fiduciary capacity from investment adviser registration.[9]

In this connection, we would note that proposed Rule 202(a)(11)-2 would except a savings association from investment adviser registration to the extent that the institution provides investment advice in its capacity as trustee, executor, administrator or guardian. To the extent a savings association provides investment advice in any other fiduciary capacity, however, it would not be excepted from investment adviser registration.

To support this distinction, the Commission relies on the common trust fund exemption provided under the Investment Company Act. This reliance is somewhat misplaced. Section 3(c)(3) of the Investment Company specifies under what circumstances a common trust fund will not be treated as an investment company.[10] That exemption governs a pooled investment product, whereas, at issue here is the capacity of a savings association as an entity to offer investment advisory services free from registration under the Investment Advisers Act. The capacity of an entity to offer securities related services free from Commission oversight requires a fundamentally different analysis than that required to determine whether an investment product need be registered prior to distribution under the federal securities laws.

Moreover, to the extent it is appropriate to borrow from one federal securities law to assist in interpreting another, it would be far better for the Commission to look to the broker-dealer registration provisions of the Securities Exchange Act of 1934 to assist in interpreting the investment adviser registration provisions of the Investment Advisers Act of 1940. Since the Congress remains steadfast in its belief that bank trust and fiduciary activities should continue to be exempt from both broker-dealer and investment adviser registration, the Commission should follow that guidance and treat savings associations similarly.

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9 We note that the Commission has proposed to grant savings associations that engage in trust and fiduciary activities an exception from brokerage registration commensurate with that provided to banks under the GLBA. See Proposed Regulation B, Release No. 334-49879, 69 Federal Register 39682 (June 30, 2004).

The fact that the Congress did not address the issue of savings associations when crafting amendments to the Investment Advisers Act should not be interpreted as a Congressional endorsement of the notion that savings associations should continue to be required to register as investment advisers. In truth, much of the GLBA, and particularly, the securities amendments contained in Title II, were directed to commercial banks only.

10 Section 3(c)(3), 15 USC 80a-3(c)(3). While it is true that the GLBA amended Section 3(c)(3) to provide, among other things, that in order to be exempt from the definition of investment company the common trust fund must be "employed by the bank solely as an aid to the administration of trusts, estates, or other accounts created and maintained for a fiduciary purpose," nowhere in the statute or the Conference Report is there any suggestion that the Commission is to determine the "bona fide" nature of the accounts' fiduciary purpose. The determination of whether an account is fiduciary in nature has long been left to the determination of state and federal fiduciary authorities. It is well-settled that college savings trusts, pension trusts and revocable inter-vivos trusts have a fiduciary purpose and are often invested in bank common trust funds exempt under Section 3(c)(3).

To give savings institutions true parity with banks, all trust and fiduciary accounts serviced by savings associations should be included within the exception, including individual retirement account (IRA) trusts, revocable inter-vivos trusts, rabbi trusts, and managed agency accounts. Banks are exempt from investment adviser registration when servicing these accounts and no reason exists not to treat savings associations similarly.

Moreover, it is difficult to comprehend why the Commission would permit a savings association to advise only those employee benefit plans invested <u>solely</u> in its collective investment funds without investment adviser registration but not allow a savings association to advise employee benefit plans that invest in registered mutual funds. It is not uncommon for plan sponsors to offer plan participants a menu of investment products that include both registered mutual funds as well as collective investment funds. These activities are subject to extensive fiduciary regulation under the Employee Retirement Income Security Act[11] and should be excepted from investment adviser registration.

<u>A Full Exception Will Not Create Regulatory Disparity between Savings Associations and Other Investment Advisory Firms.</u>

The Commission rationalizes its proposal to require savings associations to register as investment advisers when they act in any capacity other than trustee, executor, administrator, or guardian for trusts, estates, guardianships and other similar accounts by suggesting that a regulatory disparity between registered investment advisers offering retail investment advisory services and savings associations offering these same services would be created. In truth, however, regulatory disparity exists now as savings associations are subject to duplicative regulation by the Office of Thrift Supervision (if they are federally chartered savings associations and savings banks) or the Federal Deposit Insurance Corporation (FDIC) (if they are state-chartered savings associations) as well as by the Commission.[12]

Nor do we understand how investment advisory clients would be harmed if they chose to have their investment advisory needs serviced through a savings association trust department rather than in a registered investment adviser. When acting in a trust or fiduciary capacity, savings associations are subject to strict fiduciary duties, including the duty of loyalty and the corollary prohibition against self-dealing and the duty to manage fiduciary assets with the same care, skill, prudence, and diligence that a prudent person would use in managing his or her own assets. Further, transactions that raise conflicts of interest may only be entered into if specifically allowed by applicable law, a court order, the trust instrument itself or affirmatively consented to by all beneficiaries to the trust or fiduciary agreement. The ABA would respectfully

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[11] 29 USC Section 1001-1461.

[12] Federal savings associations, federal savings banks, and state-chartered savings associations would be eligible to be exempt from investment adviser registration under the proposal. Of course, the exemption should include state savings banks as well, as these institutions also hold FDIC insured deposits.

submit that a prohibition against self-dealing would seem to offer superior protections to investors than simple disclosure of existing conflicts of interest.

In this regard, we note that the high fiduciary duties placed on savings association fiduciaries and the concomitant liability for breach of these duties require trust departments to charge higher fees to fiduciary clients in recognition of the risks associated with handling these accounts. Retail investment advisory clients generally do not need the services offered by trust departments nor wish to pay the higher fees associated with those services.

Finally, any concern that integrated financial services firms will move their investment advisory activities out of their registered investment advisory firm and into an affiliated savings association is unfounded, the ABA would submit. If this were true, it would stand to reason that commercial banks and trust companies would never, prior to enactment of the GLBA, have established registered investment advisory firms. It is our experience, however, that many banks and bank holding companies, prior to 1999, acquired such firms either as de novo affiliates or through acquisition in part to reward employee investment talent and to encourage the development of leading edge investment advisory firms.

Investor Protections are Assured under a Full Exception from Investment Adviser Registration.

Section 206A of the Investment Advisers Act directs the Commission to focus on investor protection issues when considering exemptions from the Advisers Act. The Commission notes that investment advisory clients are provided with an informational brochure addressing certain conflict-of-interest issues and explaining the adviser's business practices, fees, investment policies and risks, brokerage practices (such as soft dollar usage), and industry affiliations, and must disclose their policies on voting proxies. In addition, investment advisers are restricted with respect to the content of their advertisements and the types of advisory fees they charge. A broad exception would eliminate these and other measures under the Investment Advisers Act that currently protect savings associations' retail advisory clients.

Clients of savings association trust and fiduciary departments receive the full panoply of protections afforded under federal and state fiduciary law, including strict prohibitions on self-dealing and requirements to hold fiduciary assets separate from bank assets, to invest all idle cash (down to the last penny) held in trust accounts, and to have custody and control over fiduciary assets.[13] In addition, savings association trust and fiduciary departments are required to have extensive investment and securities trading policies that address, among other things, fair and equitable asset allocation, cross-trading, and personal trading for investment personnel.[14] Finally, savings associations are extensively examined on a 12-18 month cycle by their regulators. Upon completion of the examination, savings associations are given a rating and a final report that is then communicated to the savings association's

[13] See, e.g., 12 CFR Section 550.

[14] See, e.g., 12 CFR Section 551

senior management and board of directors. The ABA would submit that savings association trust and fiduciary clients receive more than ample protection under federal and state fiduciary law to justify a complete exception from investment adviser registration.

Finally, we note that a full exception from investment adviser registration would eliminate the need for a savings association to provide the Commission access to all of the institution's trust department records. We are unalterably opposed to the notion that records for accounts that are, under the proposal, excepted from the Investment Advisers Act would nevertheless be subject to Commission review. The federal bank regulators have ample authority and experience to ferret out improper IPO and other trade allocations.

CONCLUSION

In conclusion, the ABA strongly supports a full exception from investment adviser registration for savings associations. Anything less unjustifiably denies savings associations parity with commercial banks and trust companies. Should you wish to discuss this matter further, please do not hesitate to contact the undersigned.

Sincerely yours,

(Signed on July 14, 2004)

Sarah A. Miller

cc: Paul Roye
Cynthia Fornelli
Robert Plaze
Jennifer Sawin
Jamey Basham
Robert Tuleya