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Mr. Jonathan G. Katz, Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

Re: File No. S7-20-04
Proposed Investment Advisers Act Rule 202(a)(11)-2
Certain Thrift Institutions Deemed Not To Be Investment Advisers
Securities and Exchange Commission Release Nos. 34-49639 and IA-2232

Dear Mr. Katz:

On behalf of Guardian Trust Company, FSB ("Guardian"), New York Life Trust Company, FSB ("New York Life") and Northwestern Mutual Trust Company, FSB ("Northwestern Mutual"), we are pleased to comment on the Investment Advisers Act of 1940 (the "Advisers Act") Proposed Rule 202(a)(11)-2, Certain Thrift Institutions Deemed Not To Be Investment Advisers (the "Proposed Rule"), and the accompanying Securities and Exchange Commission Release Nos. 34-49639 and IA-2232 (the "Proposing Release").

Each of Guardian, New York Life and Northwestern Mutual (together, the "FSBs") is a federal savings bank having deposits insured by the FDIC, which operates a trust company business. The trust company business model used by each of the FSBs is a proven model which seeks to provide, in the terminology of the Proposing Release, fiduciary purpose accounts and managed agency accounts in addition to a number of non-advisory financial services. At present, these institutions do not engage in significant deposit or lending activity. We regularly represent the FSBs and other savings institutions as they conduct their investment management businesses while navigating through the multiple regulatory systems described below.

Guardian, New York Life and Northwestern Mutual each sincerely appreciate the work of the staff of the Securities and Exchange Commission ("Commission") in developing the Proposed Rule and the decision of the Commission to focus a portion of its limited resources on attempting to alleviate the multiplicity of regulation which impacts the business of each of these institutions. However, the FSBs respectfully suggest that the Proposed Rule does not fully recognize the business model most typically followed by trust companies, the duplicative nature of the federal regulatory systems governing federal savings banks' investment management activities, or the competitive disadvantage that federal savings banks endure as a result of the Commission's regulation of federal savings banks under the Advisers Act. Guardian, New York Life and Northwestern Mutual firmly believe that anything short of regulatory parity with national banks results in a government generated distortion of the competitive landscape for national trust company business without any countervailing public

benefit, and they intend to continue to pursue legislative and additional administrative avenues to fully remedy this situation. We note that the FSBs have elected not to directly address the specific questions presented throughout the Proposing Release based on their belief that the overall approach taken in the Proposed Rule will not provide any significant benefit to the FSBs.[1] We set forth below the FSBs' principal rationale for their belief that Advisers Act regulation of FSBs is unnecessary and anticompetitive.

The Appropriate Regulatory Comparison is to National Banks

Initially, we note that most investment advisers (*e.g.* those not organized as financial institutions, the "traditional investment advisers") are subject to Commission regulation under the Advisers Act and that the Advisers Act was adopted with traditional investment advisers in mind. Additionally, such traditional investment advisers' investment adviser representatives[2] and third-party solicitors are subject to regulation as such under state law. However, in recognition of the differences between the traditional investment adviser and most financial institutions which operate trust companies, most financial institutions (such as national banks) are not subject to Commission regulation under the Advisers Act. National banks, for example, are primarily regulated in their advisory activity by the Office of the Comptroller of the Currency ("OCC"), which provides a comprehensive regulatory system for national banks. Moreover, most financial institutions, such as national banks, are not subject to state regulation as investment advisers and their investment adviser representatives and third-party solicitors are not subject to state regulation as such. Federal savings banks, however, are subject to dueling federal regulation with respect to their advisory activities by both the Office of Thrift Supervision (the "OTS") and the Commission. Additionally, their investment adviser representatives and third-party solicitors are subject to regulation as such under state law. Of these three categories of advisers (*i.e.*, the traditional adviser, most financial institutions that operate trust companies and federal savings banks), federal savings banks are the only one which are subject to multiple federal regulatory systems with respect to their advisory activities and, under the current system, are subject to the greatest number of different regulatory systems (*i.e.* three). When these three categories of advisers are analyzed, federal savings banks are most similar to, and compete most directly with, national banks (which fall in the second category).

Notwithstanding the very different federal regulatory treatment of federal savings banks and national banks, as recognized by the Commission in the Proposing Release, federal savings banks and national banks have similar fiduciary powers and are similarly regulated.[3] When a national bank

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[1] *See* Statement of John E. Bowman, Chief Counsel, Office of Thrift Supervision concerning Regulatory Burden Relief before the Committee on Banking, Housing, and Urban Affairs, United States Senate, June 22, 2004 ("Testimony of John E. Bowman, June 22, 2004") ("The practical effect of this approach is that it provides an extremely limited exemption that is beneficial to few thrifts.")

[2] As defined under the Advisers Act at Rule 203A-3.

[3] Footnote 13 of the Proposing Release. This is in stark contrast to the situation that existed at the time of the adoption of the Advisers Act, when federal savings banks did not have similar fiduciary powers or similar regulation to national banks.

operates a trust company, following a common and proven model, it provides fiduciary purpose accounts, managed agency accounts and other non-advisory services, just as Guardian, New York Life and Northwestern Mutual do. As discussed in Footnote 13 of the Proposing Release, the OTS and the OCC regulation of the exercise of fiduciary powers are substantially similar (in fact, the OTS regulation mirrors that of the OCC in most respects) and the OTS maintains[4] that its regulatory system, like that of the OCC, is a comprehensive one, focusing on the safety and soundness of the financial institution. Of particular relevance to the question of investment adviser regulation, the FSBs believe that a financial institution cannot be safe or sound if it does not generally meet its obligations as a fiduciary of its investment management clients, whether those clients are in so-called fiduciary purpose accounts or managed agency accounts. Of particular note, the provision of any investment management service by a federal savings bank (whether a fiduciary purpose account or a managed agency account) is an exercise of its fiduciary powers.[5] Since the inception of each of the FSBs, the OTS has conducted regular examinations on a twelve to eighteen month cycle and, as part of those examinations, it has conducted in-depth reviews of their fiduciary operations. While we recognize that the regulatory systems of OTS and OCC financial institution regulation and Commission adviser regulation are different, both sets of regulation have similar goals of ensuring a fiduciary standard to customers is met in connection with the provision of investment advisory services. The FSBs believe that it is through the existence and regulatory monitoring of a fiduciary duty to clients (whether through a system of regulation based primarily on disclosure or a system based primarily on examination for safety and soundness) that the goal of investment management client protection is served. Moreover, based on the absence of empirical evidence of any significant investment management customer loss within national banks, the financial institution model of regulation of the trust company operations of national banks has been generally successful from an investor protection standpoint, even though national banks have only one system of federal regulation governing those activities. This lack of evidence of significant customer loss, in the context of institutions that are highly regulated and closely supervised, strongly suggests that there is little countervailing public benefit to additional regulation. Therefore, we respectfully suggest that duplicative regulation imposes additional burdens on federal savings banks without any significant additional protection to customers.

<u>Burdens Relative to State Law Compliance</u>

Most registered investment advisers received a benefit as a result of the National Securities Markets Improvements Act of 1996 ("NSMIA"), in that this statute bifurcated regulation of investment

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[4] Testimony of John E. Bowman, June 24, 2004; Letter from Scott L. Albinson, Managing Director, Office of Supervision, Office of Thrift Supervision, to Annette L. Nazareth, Director, Division of Market Regulation, and Paul F. Roye, Director, Division of Investment Management, U.S. Securities and Exchange Commission (March 20, 2001); Letter from Ellen Seidman, Director, Office of Thrift Supervision, to Harvey L. Pitt, Chairman, U.S. Securities and Exchange Commission (December 3, 2001).

[5] 12 CFR 550.30; *see also* Testimony of John E. Bowman, June 24, 2004 ("The accounts in both categories are fiduciary accounts that receive the same protections under the HOLA and OTS regulations and are subject to similar examination scrutiny.")

advisers between the federal government and the States. In passing NSMIA, Congress recognized that having multiple regulators govern the same activity was inefficient and unnecessary. Federal savings banks, however, did not enjoy such a reduction in regulation as a result of NSMIA; instead, NSMIA proved to be the genesis of additional burdens and compliance responsibilities for federal savings banks operating trust companies. When the various states adopted amendments to their securities laws in response to NSMIA, most states adopted the revisions made to the Uniform Securities Act. These revisions, essentially, created a new category under state law called a "federal covered adviser." This new category of adviser was subject to notice filings in the various states and their investment adviser representatives and third-party solicitors were subject to regulation as such under state law. This new regulation, meant to take account of the elimination of dual regulation pursuant to NSMIA while maintaining certain state revenues, was implemented against a backdrop of investment adviser regulation in nearly every state which excludes savings institutions, such as federal savings banks, from such regulation. Therefore, prior to NSMIA, federal savings banks were subject to investment adviser regulation only at the federal level. Based on federal savings banks being "federal covered advisers" following NSMIA, federal savings banks were, arguably, inadvertently captured by new state investment adviser regulation. Although not all states' laws are subject to interpretation in this manner, the possibility of this interpretation in many state laws results in an additional obligation on federal savings banks to monitor on a continuous basis the investment adviser laws of all 50 states. On behalf of certain of our clients we have requested interpretative positions from a number of states indicating that the intent of the change in their law was not to begin, for the first time, to regulate federal savings banks as investment advisers. While most states have provided a favorable interpretation, generally on policy grounds in order to eliminate an uneven playing field with national banks, certain states refused to provide such assurance. Because national banks have the ability to operate their trust company operations in all 50 states without the need to monitor state investment adviser regulation, including regulation of investment adviser representatives and third-party solicitors, national banks have a competitive advantage over federal savings banks. This competitive advantage stems directly from the additional costs born by federal savings banks to monitor compliance or the need for compliance with regard to their operations which may exist in all 50 states. The solution to this competitive imbalance lies in taking federal savings banks out of the definition of federal covered adviser, something which is not accomplished under the Proposed Rule unless federal savings banks change their business model in a manner that will make their ability to succeed in the trust company business somewhat remote, as described below.

Proposal Does Not Recognize Common Business Model of Trust Companies

The primary challenge that Guardian, New York Life and Northwestern Mutual see with the Proposed Rule, is that it fails to account for what they believe is the traditional or classic business model followed by a successful trust company. They submit that the business model followed by most successful trust companies involves the provision of investment management services to both fiduciary purpose accounts and managed agency accounts through a single coordinated operation. In other words, as a structural matter, the successful trust company model does not involve two

separate divisions within a trust company -- one to provide services for fiduciary purpose accounts and one to provide services for managed agency accounts. To the contrary, there is typically a single person or a small group that serves as the primary client interface such that this person or small group may have a more complete understanding of the client's needs, which often include multiple account relationships, with some falling into the Proposed Rule's fiduciary purpose account category and others falling into the Proposed Rule's managed agency account category. Therefore, the trust company's operations are combined, and arguably must be combined, in order to have an ultimately successful operation.[6] This is because the generation of fiduciary purpose account business is often closely related to the generation and conduct of managed agency account business. In selecting a trust company to provide a fiduciary purpose account, many customers often prefer to initially "try out" the services of a trust company through the use of a managed agency account. Managed agency account relationships are generally much easier to enter and exit than fiduciary purpose account relationships. Partially for this reason, the time involved in obtaining a fiduciary purpose account customer tends to be much greater than the time involved in obtaining a managed agency account customer. It is quite often through a managed agency account customer receiving service in that capacity that a trust company has an opportunity, over time, to obtain a fiduciary purpose account customer (the "crossover effect"). However, in order to achieve any of the efficiencies suggested in the Proposing Release, a federal savings bank would have to separate its business into divisions (*i.e.* one for fiduciary purpose accounts and one for managed agency accounts). If trust companies were to conduct their fiduciary purpose and agency account business as completely separate units, this "crossover effect" would tend to be much less. Obtaining a fiduciary purpose relationship with a client would be much more akin to the sale of a separate and distinct entity's product. The idea of a customer "trying out" the trust company, and the ability of the trust company to demonstrate its abilities and service to a client prior to the initiation of a long term relationship such as a fiduciary purpose account, would be lost. Even with dividing the trust company's business into separate divisions, the conduct of the trust company business in this manner would still result in the federal savings bank being a federal covered adviser and, therefore, the state compliance burden would remain. In order to alleviate this additional burden, a federal savings bank would be required to shed its agency business and place it in a legally separate entity with a separate management and staff. Upon doing this, the revenue-earning potential of the federal savings bank would decrease significantly (*i.e.* because of the loss of managed agency account business) and, with this, certain economies of scale necessary for success would not be achieved. Additionally, because of the loss of the "crossover effect", the trust company's ability to obtain fiduciary purpose accounts would also be severely harmed (particularly for new entrants into the trust company business, where the "crossover effect" is particularly important). National banks, which have the ability to obtain additional revenue from managed agency accounts and which have the advantage of the "crossover effect," would continue to enjoy a significant competitive benefit over federal savings banks in the trust company business.

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[6] Testimony of John E. Bowman, June 22, 2004 ("In fact, from a safety and soundness standpoint, we would have to question the rationale behind such [a disjunctive] approach.")

Once again, Guardian, New York Life and Northwestern Mutual do applaud the Commission for attempting to address the uneven playing field between national banks and federal savings banks in the investment management area. The FSBs desire adoption of a rule which would place federal savings banks in regulatory parity with national banks by exempting federal savings banks from Commission regulation under the Advisers Act. However, as described above, each of these institutions strongly feels that the Proposed Rule will only perpetuate the uneven playing field and the unfair competition. Even if the current Proposed Rule is adopted, these institutions will feel the need to continue to press for legislative change. Guardian, New York Life and Northwestern Mutual appreciate the Commission's consideration of our comments. Please direct any questions regarding this letter to the undersigned at (312) 443-1823.

Very truly yours,

LORD, BISSELL & BROOK LLP

Michael K. Renetzky

MKR:pml

cc: The Hon. William H. Donaldson, Chairman
The Hon. Paul S. Atkins, Commissioner
The Hon. Roel C. Campos, Commissioner
The Hon. Cynthia A. Glassman, Commissioner
The Hon. Harvey J. Goldschmid, Commissioner
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