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WACHOVIA

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Submitted Electronically: rule-comments@sec.gov
Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
450 5th Street, N.W.
Washington, D.C. 20549

Re: Proposed Regulation B - Release No. 34-49879; File No. S7-26-04

Dear Mr. Katz:

Wachovia Bank, National Association ("Wachovia") is writing to comment on proposed Regulation B of the Securities and Exchange Commission ("Commission"), issued by the Commission on June 17, 2004. Regulation B addresses the exemptions for banks from the definition of "broker" under Section 3(a)(4) of the Securities Exchange Act of 1934 ("Exchange Act"), as amended by the Gramm-Leach-Bliley Act ("GLBA"), and provides additional exemptions for banks from the Exchange Act's broker-dealer registration requirements.

Wachovia appreciates the opportunity afforded by the Commission to comment on the proposed regulation and the willingness of the Commission Staff during the drafting process to discuss with financial services companies such as ours the issues raised by the proposed rules. Wachovia commends the Staff for taking the industry's views into account and attempting to address our concerns in the development of the proposed regulation.

Wachovia has participated in the preparation of comment letters (the "Industry Letters") on proposed Regulation B that are being submitted to the Commission by four industry groups, and we strongly support the views expressed in those letters. The Industry Letters are those submitted by The Clearing House Association LLC, the American Bankers Association, the Financial Services Roundtable and The Groom Law Group on behalf of ten banks and trust companies that provide services to employee benefit plans.

As made clear in the Industry Letters, notwithstanding the willingness of the Staff to consult with and receive the considered opinions of representatives of the financial services industry during the drafting process, we are disappointed that the regulation as proposed departs so substantially from the intent and objectives of Congress in its passage of Title II of

GLBA, the section of that 1999 law that the proposed regulations are intended to implement. Although Congress in Title II repealed the blanket exemption that banks enjoyed from the definitions of "broker" and "dealer" under the Exchange Act, Congress did not intend to require that banks seek exemptions from SEC regulation in order to be able to continue to engage in traditional banking and fiduciary activities. Rather, Congress expressly included statutory exceptions in Title II with the intent that banks could continue to conduct their banking and fiduciary activities without being subject to regulation by the Commission or needing to ask the Commission for an exemption from such regulation.

Unfortunately, the Commission's approach to rule-making in this instance largely has the effect of vitiating the statutory exceptions that Congress expressly put in place. In so doing, as explained in the Industry Letters, the Commission has proposed a regime of rules, restrictions and tests that is so complex and burdensome as to be incompatible with the clear intent of Title II. Therefore, we respectfully request that the SEC reconsider its approach to this regulation, revisit the plain language, legislative history and intent of Title II and implement only such rules as are necessary to and consonant with the Congressional purpose behind Title II.

In addition to these overarching comments and our adoption of the positions taken in the Industry Letters, Wachovia in this letter provides specific comments regarding (1) the trust and fiduciary activities exception and (2) the impact of the proposed rules on the services that Wachovia provides to employee benefit plans. We now turn to those comments.

I. Comments Relating to the Trust and Fiduciary Activities Exception

A. Line of business definition

Proposed Rule 721 provides an option for banks to assess compliance with the chiefly compensated test on a line-of-business basis rather than on an account-by-account basis. For this purpose, Proposed Rule 724(e) defines a "line of business" as an "identifiable department, unit, or division of a bank organized and operated on an ongoing basis for business reasons with similar types of accounts and for which the bank acts in a similar type of fiduciary capacity as listed in [section 3(a)(4)(D) of the Exchange Act]."

Wachovia agrees that it is appropriate to limit the exemption to legitimate trust and fiduciary activities that are executed in areas of a bank organized and authorized to conduct those activities. However, Wachovia believes the proposed definition of "line of business" – which is premised upon how a bank's trust and fiduciary activities are organized and conducted -- should be consistent with the identification of those trust and fiduciary activities authorized by the applicable federal banking statutes as implemented by regulations of the federal bank regulatory agencies.

Wachovia, as a federally-chartered national bank, conducts its trust and fiduciary activities pursuant to powers provided by the National Bank Act, 12 U.S.C. 92a, and the implementing regulations of the Office of the Comptroller of the Currency ("OCC"), 12 C.F.R. Part 9. Section 92a defines trust and fiduciary activities as those occasions in which national banks act in the capacity of trustee, executor, administrator, registrar of stocks and bonds, transfer agent, guardian, assignee, receiver, or custodian under a uniform gifts to minors act; investment adviser, if banks receive a fee for their investment advice; any capacity in which banks possess investment discretion on behalf of another; or any other similar capacity that the OCC authorizes pursuant to Section 92a.

Wachovia submits that, to minimize the costs associated with tracking compensation components that have no independent meaning for banking institutions, whether the trust and fiduciary exception is applicable to a bank should not depend on whether or not those activities are performed within any particular line of business, but simply on whether or not they are performed within the bank pursuant to applicable statutory and regulatory authorization. The proposed regulation already requires that the bank relying on the exemption be regularly examined by its primary functional regulator, and in such examinations, it is Wachovia's experience that the OCC examines as to type of account (*i.e.*, similarly-coded accounts, as determined by the bank's internal coding system) regardless of where in Wachovia the particular account may be managed. It is Wachovia's obligation to ensure that all of its accounts follow bank-wide policies and procedures, compliance with which is under the ultimate oversight of the Trust Committee, a committee of the Board of Directors of Wachovia Corporation, Wachovia's parent holding company. Thus, regardless of where in Wachovia a particular trust or fiduciary account may be managed or administered, it will be managed or administered in accordance with the same sets of policies, procedures and practices applicable to all similarly coded accounts (modified, within Wachovia's discretion, to meet the specific objectives and needs of the beneficiaries named in the account).

Because only trust and fiduciary accounts may be eligible for the trust and fiduciary exception, it is not necessary to analyze those accounts by forcing them into a "line of business" that may have no other connection with the other accounts in that line of business. Wachovia realizes that this may at present be an exception rather than the rule, but Wachovia has a unique organization, and provides trust and fiduciary services from two of its four core banking groups. As business models and distribution channels continue to expand and as market segmentations continue to be refined, it is possible that trust and fiduciary accounts may be separated into more distinct business lines. For Wachovia to separately and continually analyze each of these business lines, solely to perform the due diligence necessary to maintain compliance with the Commission's regulations (when all trust and fiduciary accounts are still subject to the overall bank policies and procedures) will be costly, and time consuming and provide no independent information or benefit.

B. Sales compensation and relationship compensation

Proposed Rule 721 implements the "chiefly compensated" test by means of a limitation on the ratio of "sales compensation" to "relationship compensation." Wachovia believes the compensation comparison and limitation should be between sales compensation and total compensation received for conducting trust and fiduciary activities, rather than between sales compensation and relationship compensation as provided in the proposed regulation.

Wachovia believes the relationship compensation definition inappropriately and unrealistically separates out as irrelevant (and thus not counted) otherwise legitimate components of a bank fiduciary's compensation. The identified "neither sales nor relationship" components include, but are not limited to, tax preparation and real estate management. Usually, the trustee's compensation is calculated as a simple percentage of assets under management, with an additional fee that may be imposed, depending on the overall size and complexity of the trust, for other assets such as real property or closely held business interests, or other activities such as tax preparation and bill paying services. For an account that holds real property, much of the trustee's activities with respect to that account will be related to issues arising with respect to the real estate. The real estate and its effect upon the trust are part and parcel of the "relationship" between the trustee and the trust's beneficiaries. Banks do not charge for the "relationship," and unless "relationship" is viewed as the entire account, and thus is the "total" compensation, banks will be required to track and calculate a compensation category that has no independent meaning for them. Under the proposed regulation, it appears that the "relationship" is akin to system administration, and the trustee is permitted to charge for that administration as something other than sales. The philosophical underpinning of the proposed regulation misses the point that trustees and other fiduciaries are not principally concerned with purchasing and selling securities, and the activities a trustee performs are not limited to one of either securities transactions or account maintenance. To adequately ensure that a bank as trustee or fiduciary is not unduly compensated for the portion of its investment work for the account from "sales" compensation, compensation from sales should be viewed in light of the total account picture, and total account compensation, not as against "relationship" compensation.

Thus, Wachovia is more concerned about the burden of determining "relationship" compensation as a portion of the total compensation (just so the bank can then compare that relationship compensation to sales compensation) than the risk of being out of compliance. To maximize flexibility and minimize compliance burdens, Wachovia requests that the compensation calculation compare "sales" compensation to the fiduciary's "total" compensation, and that this calculation be permitted to apply on a bank-wide basis for similarly-coded accounts.

Finally, it is industry practice for banks to earn a credit on fiduciary funds awaiting investment or distribution that are deposited in the commercial or savings or other department of the bank, provided such practice meets requirements imposed by the banking regulatory agencies. Wachovia requests that the Commission acknowledge this industry practice and clarify that it does not consider such credits to be sales compensation within the meaning of the proposed regulation.

II. Comments Relating to the Impact of the Proposed Regulation on Wachovia's Services to Employee Benefit Plans

A. Summary of Comments

Wachovia believes that Congress intended that Title II of GLBA would allow banks to continue to provide services to employee benefit plans without any disruption by including a specific exception for banks providing plan services under Exchange Act section 3(a)(4)(B)(viii)(ee). However, Regulation B, as proposed, would thwart this intent and, instead, adversely affect the services that Wachovia and other banks provide to plans, without providing better investor protection or other benefits to plans and participants.

In particular, proposed Rule 770(a)(1), which would require banks to offset or credit compensation received from mutual fund complexes against other plan fees on a dollar-for-dollar basis, will significantly disrupt the services Wachovia provides to plans. Like many banks, Wachovia provides a "bundled" package of plan services, including comprehensive trust, custody, recordkeeping and other administrative services, including processing plan investment transactions. For these "bundled" services, Wachovia is compensated through payments made from mutual fund complexes; plans pay little or no direct fees. These bundled service arrangements are structured to comply with guidance issued by the U.S. Department of Labor ("Labor Department") under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), which permits plan sponsors and other plan fiduciaries to agree that plan service providers, including banks, may be compensated by mutual fund complexes for plan services without any offset, under certain conditions (including specific disclosure requirements). Plan sponsors (and other fiduciaries) of plans investing in mutual funds prefer bundled service arrangements because they simplify the payment of plan administrative costs and make it easier to evaluate investment return after total plan expenses are taken into account.

Imposing a dollar-for-dollar offset requirement would force Wachovia and other banks to completely restructure and renegotiate the bundled service and compensation arrangements preferred by plan sponsors and other plan fiduciaries responsible for selecting plan service providers. This will result in a number of problems. First, administering a dollar-for-dollar arrangement requires complex administrative processes (which do not currently exist and will have to be built), which will add to plan administrative costs, complexity, and confusion for plan sponsors and participants. In fact, plan fees are likely to increase under arrangements in which plan fees are stated and then offset with compensation paid from mutual fund complexes. It also is simpler for plan fiduciaries and plan participants to evaluate plan investment return where all plan costs are included in the funds' net asset value; changing this will make it more difficult for plan sponsors and participants to understand the impact of plan fees on plan investment returns. Because of these and other issues, discussed in more detail below, plan sponsors and other plan fiduciaries have demanded that the retirement services industry use the bundled service model that has become standard. If not permitted to offer this service model, Wachovia and other banks will be significantly disadvantaged in competing with broker-dealers, mutual fund complexes and other non-bank plan service providers that would not be required to perform a dollar-for-dollar offset and could continue to offer the bundled service service model.

Other conditions under proposed Rule 770 would adversely affect Wachovia and other banks that provide plan services, and we respectfully request that it be modified, as follows.

- Proposed Rule 770 does not cover all of the types of employee benefit plans receiving services from Wachovia, incuding church plans, certain governmental plans, and non-qualified deferred compensation plans. These types of plans receive services from the same Wachovia business unit that provides services to the plans described by sections 401(a), 403(b) and 457 of the Internal Revenue Code of 1986, as amended (the "Code"), which are covered in proposed Rule 770. If the rule is not expanded to cover these other types of plans, Wachovia would likely have to restructure its business, develop a solution for excluded plans, or even stop providing services to some types of plans. This would disrupt the administration of these plans and put Wachovia at a competitive disadvantage relative to other service providers not subject to restrictions on the types of plans to which they may provide services.

- The incentive compensation prohibition under proposed Rule 770(a)(4) is ambiguous and could interfere with compensation programs for Wachovia's retirement plan service employees. These programs, which are based on the value of compensation Wachovia anticipates receiving directly and indirectly from plan clients, do not provide employees with a "salesman's stake" in plan securities transactions. Further, ERISA and other laws already regulate employees' marketing activites. Therefore, this condition should be deleted.

- Proposed Rule 770 does not provide relief where plans invest in securities other than mutual funds, including securities issued by an employer of employees covered by the plan ("employer securities"). However, plan investments in employer securities are common, and plan sponsors and fiduciaries expect bank trustees and custodians to provide transaction services for employer securities owned by plans. Therefore, proposed Rule 770 should be extended to cover transactions in securities other than mutual funds, including employer securities. Without this change, Wachovia and other banks will not be permitted to provide services that plans expect will be provided, placing them at a competitive disadvantage relative to other plan service providers not subject to similar limitations.

The Commission states that it intends to accommodate banks' current business practices, balanced with conditions that are designed to protect investors.[1] At this point, proposed Rule 770 would not accomplish this goal. Accordingly, Wachovia urges the Commission to revise proposed Rule 770 as requested above.

We describe below the services Wachovia provides to plans, and then discuss in more detail Wachovia's specific concerns and recommendations with respect to proposed Rule 770.

B. Background

Wachovia is one of the largest providers of retirement trust services in the United States, with approximately $60 billion dollars of assets held on behalf of more than 4,500 employee benefit plans and 1.2 million plan participants. Wachovia has historically provided trust and custody services to a wide variety of clients, including retirement and other employee benefit plans. Today, Wachovia continues in the business of providing trust and custody services to employee benefit plans, primarily with respect to plans established by small and medium-sized employers. Plans receiving services from Wachovia include -

- tax-qualified retirement plans,[2] including stock bonus, pension and profit-sharing plans meeting requirements for qualification under Code section 401(a), plans described by Code section 403(b), governmental plans as defined by Code section 414(d) (including governmental plans described by Code section 457), and "church plans" described by Code section 414(e);[3]

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[1] See 69 Fed. Reg. at 39685. This is consistent with Congressional intent that GLBA's revisions to section 3(a)(4) of the Exchange Act should not change banks' traditional securities activities provided through bank trust departments and other customary banking activities. See Conf. Rep. 106-434 at 163-164 (Nov. 2, 1999).

[2] The operation and administration of these tax-qualified plans (other than governmental and church plans, and certain section 403(b) plans) is governed by ERISA.

[3] Tax-qualified retirement plans receiving services from Wachovia include (a) "defined benefit" plans under which participants receive a fixed or determinable benefit based on a plan formula, and (b), more commonly, "defined contribution" plans, including 401(k) and similar plans, which provide participants a benefit that depends on the value of employer and participant contributions made to participants' individual accounts under the plan and earnings based on the plan's investment success.

- voluntary employee benefit associations ("VEBAs"), which are trusts established to fund benefits under health, disability and similar plans offered by employers;[4] and

- non-qualified deferred compensation plans, which are established by employers to provide benefits to management or other highly compensated employees. These plans are usually "unfunded," but plan sponsors may set aside funds through a "rabbi trust" or other account in connection with the employer's liability under the plan.[5]

A single Wachovia business unit provides trust, custody and other services to these types of plans, including tax-qualified plans, non-qualified deferred compensation plans, and other plans. If uniform relief from broker-dealer regulation is not available with respect to all of these various types of plans, Wachovia would likely have to restructure its business unit, develop a solution for excluded plans, or even stop providing services to some types of plans.

The investments of some plans receiving services from Wachovia (including defined benefit retirement plans, VEBAs and some other types of plans) are managed by one or more plan fiduciaries, including a plan trustee, employer or other named fiduciary of the plan, an investment manager, or a combination of these ("fiduciary-managed plans"). The assets of these "fiduciary-managed" plans may be invested in any type of securities or other property, including employer securities, but most of these fiduciary-managed plans receiving services from Wachovia primarily invest in mutual funds. Wachovia effects purchases and redemptions of shares of mutual funds for these plans according to instructions from the plan sponsor, an investment manager or other plan fiduciary independent of Wachovia.

Other plans (including defined contribution plans and most non-qualified deferred compensation plans[6]) are "participant-directed" — that is, plan participants elect how to invest their individual participant accounts under the plan among various investment options. A plan sponsor or other named fiduciary of each plan selects the plan's investment options. Usually, these options are mutual funds, but other investment options may be included under

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[4] VEBAs are entities created under Code section 501(c)(9). They fund "welfare" benefit plans covered by ERISA, and thus are subject to ERISA. VEBA assets may be invested in securities or other property, including (among other things) mutual funds, insurance contracts or employer securities.

[5] However, the assets of the trust or custody account remain available to the employer's creditors in the event of insolvency, and participants only have an unsecured contractual promise from the employer to pay benefits when due under plan terms. Thus, although assets may be set aside, the plan remains "unfunded." Unfunded non-qualified deferred compensation plans typically are exempt from most of the substantive requirements under ERISA. See ERISA §§ 201(2), 301(a)(3), 401(a)(1).

[6] Often, non-qualified deferred compensation plans are structured so that participants may choose from a set of hypothetical investment options to determine how earnings are credited to their plan contributions. Accordingly, the plans are managed and administered very much like other participant-directed plans.

a plan. For example, employer securities may be offered as an investment option. Other options selected by the plan sponsor or other plan fiduciary could include bank collective trust funds, a "separate account" consisting of assets under management by a trustee, plan fiduciary or investment manager, or participant-directed brokerage accounts that allow plan participants to invest in securities through a registered broker-dealer. Wachovia may provide plans objective information to assist the plan sponsor or other plan fiduciaries in selecting among the mutual funds that Wachovia makes available to plans and in monitoring the selected investment options, but Wachovia generally does not provide any advice or recommendations with respect to the selection of mutual fund investment options.

For the vast majority of its plan clients, Wachovia serves as a "directed trustee" or "custodian." A plan may ask Wachovia to act as a "directed trustee" so that a plan satisfies the ERISA section 403(a) "trust requirement." Alternatively, Wachovia could be a "custodian" because another person or entity is appointed as plan trustee.[7] However, Wachovia generally has similar responsibilities whether or not it acts as a directed trustee or custodian. It is responsible for receiving plan contributions and other assets and the custody and safekeeping of plan assets. Wachovia generally has no discretionary investment responsibility or authority. Instead it only implements the investment directions of a plan sponsor or other plan fiduciaries (e.g., an investment manager) or, if the plan is participant-directed, instructions from plan participants.

Wachovia also provides specialized plan recordkeeping and administrative services. These include (a) providing prototype plan and trust documents, summary plan descriptions, sample plan forms and other written plan materials; (b) assisting employers with plan set up, employee enrollments and employee education (including providing enrollment forms and participant education materials); (c) maintaining and updating on a daily basis participant accounts; (d) taking investment instructions from plan participants using multiple systems (including by written instructions, by automated telephone voice response and live operator telephone services, and internet-based services); (e) processing participant investment instructions, including allocating participant contributions and processing participant exchange requests among multiple plan investment options (such as mutual funds, bank collective trust funds, employer securities and other options); (f) processing other plan transactions, such as participant loan requests, withdrawal requests and other plan distributions; (g) providing compliance testing and other services required to maintain the plan's tax-qualified status; (h) preparing and delivering periodic participant statements and other participant communications materials; (i) proxy distribution and other shareholder

[7] For example, laws establishing certain governmental plans provide for a trustee committee responsible for the management and control of plan assets. Some tax-qualified retirement plans are collectively bargained multi-employer plans jointly managed by a board of employer and union trustees (commonly called "Taft-Hartley" plans). Some private-sector employers appoint one or more officers or other individuals to serve as plan trustee to meet the ERISA section 403(a) trust requirement. In all of these situations, Wachovia may serve as a custodian.

services; and (j) drafting the annual Form 5500 report. These recordkeeping and administrative services for participant-directed plans are very complex, require specialized expertise, and are expensive to provide.

As noted, Wachovia generally provides services to plans under so-called "bundled service" arrangements under which a plan sponsor or another plan fiduciary agrees that Wachovia will be compensated for most or all of the plan's service costs indirectly through amounts paid by mutual fund complexes (including agents of mutual funds, such as the fund manager, administrator or principal underwriter). Similar bundled service arrangements are widely offered throughout the benefit plan industry by banks, mutual fund complexes, broker-dealers and other non-bank service providers. Typically, the plan account or participant accounts under a plan are not billed or invoiced directly for the standard bundled services, or only pay nominal fees for such services.[8] In this regard, plan sponsors or other plan fiduciaries negotiating plan service arrangements with Wachovia generally demand that Wachovia limit its compensation to the amount available to be paid by mutual fund complexes. As noted above, if compensation from mutual fund complexes were not available, Wachovia would have to restructure its business model and would be at a significant disadvantage relative to broker-dealers, mutual fund complexes and other non-bank plan service providers that would not be required to perform a dollar-for-dollar offset.

Amounts paid from mutual funds may include fees paid from the fund for shareholder sub-accounting and other administrative services, or for shareholder services. Payments also may be made under "revenue-sharing" agreements with managers of the mutual funds. This compensation is mostly "asset-based" — that is, determined as percentage of the plan's average balance invested in mutual funds. A few funds compensate Wachovia for shareholder sub-accounting or other administrative services with a "per head" fee (e.g., $7 per participant account in a fund) rather than an asset-based fee. Also, mutual fund complexes may pay "finders fees" on new accounts based upon a percentage of the value of new investments.[9]

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[8] Wachovia may provide other services depending on plan requirements, such as information investment reporting to the plan sponsor or other named fiduciary selecting plan investment options, or participant education services. In some cases, Wachovia may also contract to provide investment consulting services to the plan sponsor or other named fiduciary selecting plan investment options, or to provide participant advice. In addition, Wachovia may also provide other services including services with respect to the administration of employer securities investments, services with respect to participant-directed brokerage accounts, cash management services, plan distributions, and specialized financial reporting and accounting services. Wachovia may charge additional fees for these services and the plan would pay the fee to Wachovia directly, or the plan sponsor or other plan fiduciary might negotiate to obtain these services as part of the bundled service arrangement for no additional charge.

[9] If a plan selects a mutual fund managed by a Wachovia affiliate, the affiliate receives asset-based investment management fees. Wachovia or an affiliate also may receive custodial, administrative and

Wachovia almost never offsets or credits compensation from mutual fund complexes against fees that plans are otherwise obligated to pay.[10] Indeed, because plans generally are not obligated to pay directly any fees (or only nominal fees) for services under bundled service arrangements, there generally are no plan level fees to offset. Importantly, however, the compensation Wachovia may receive from mutual funds for providing plan services under a bundled service arrangement is not unlimited. Rather, ERISA requires an independent plan fiduciary to determine that the service and fee arrangement with Wachovia is reasonable, and that Wachovia receives no more than "reasonable compensation" for its services. This requires the independent plan fiduciary to consider all sources of compensation received by Wachovia, including compensation received from mutual funds.[11]

Wachovia provides detailed disclosure to the plan sponsor or other responsible plan fiduciary about the compensation and fees Wachovia receives for plan services. Compensation received from mutual fund complexes is specifically disclosed in accordance with Labor Department guidelines.[12] Specifically, Wachovia provides materials to the plan sponsor or other plan fiduciary responsible for engaging Wachovia at the outset of the engagement that describe the services Wachovia provides to mutual funds and to plans and the rate or range of rates at which each mutual fund complex compensates Wachovia. All compensation from mutual fund complexes is disclosed, including payments under revenue-sharing agreements and finders fees.

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transfer agency services from these affiliated funds. Fees for administrative and transfer agency services may be asset-based or based on a fixed fee for services schedule or a combination of these.

[10] There are about 10 plan relationships in which Wachovia performs a dollar for dollar offset of compensation from mutual funds against other fees. These are some of Wachovia's largest plan clients and the dollar for dollar offset fee arrangement was separately negotiated with the plan sponsor or another plan fiduciary. Wachovia performs the dollar for dollar offset using a manual process.

[11] See ERISA § 408(b)(2). DOL regulations provide that an arrangement is "reasonable" only if the services provided are necessary and appropriate to the plan, the arrangement is terminable without penalty on reasonably short notice, and the plan pays no more than "reasonable compensation." 29 C.F.R. § 2550.408b-2(a). "Necessary services" are services that are "appropriate and helpful to the plan" in carrying out the purposes for which a plan is established or maintained. 29 C.F.R. § 2550.408b-2(b).

[12] DOL Advisory Opinion 1997-16A (May 22, 1997) requires plan service providers receiving compensation from mutual fund complexes in connection with plan investment transactions to (i) disclose the fact that the service provider receives compensation from fund complexes and the services provided to the funds and to the plan in connection with the compensation, (ii) disclose the basis on which the compensation is determined, including the rate or range of rates at which the fees are determined, and (iii) provide a statement that additional information is available on request, including an estimate of the compensation amounts and a point of contact for additional information.

Each plan sponsor or other plan fiduciary has the opportunity to ask questions about the compensation paid by mutual funds, including requesting an estimate of the amount of compensation Wachovia receives annually with respect to a plan's investments. This information is updated any time that there is a change in the mutual funds or the compensation paid by mutual funds in which the plan invests. Further, each year in connection with annual Form 5500 reporting, Wachovia provides the plan sponsor (or other plan fiduciary that is ultimately responsible for completing the Form 5500) with the actual dollar amount received by Wachovia during the previous year, which may be reported on Form 5500 Schedule C (Service Provider Compensation) at the option of the plan administrator.

C. Comments on Regulation B

Wachovia's ability to continue its trust, custody and other services to employee benefit plans will be at risk with the implementation of the functional exceptions from broker-dealer regulation under Exchange Act section 3(a)(4), as these provisions have been interpreted by the Commission in connection with proposed Regulation B. In this regard, the Commission's interpretation that the safekeeping and custody exception for banks providing services to employee benefit plans under section (a)(4)(B)(viii)(ee) does not allow any "order-taking" makes that exception unavailable to Wachovia.[13] However, taking and implementing investment instructions is a component of the package of bundled services Wachovia provides to plans, which could not be "unbundled" from the related plan and participant recordkeeping and custody services Wachovia provides to plans.

The section 3(a)(4)(B)(ii) trust and fiduciary activities exception also will not be available to Wachovia in providing services to most employee benefit plan clients. First, the exception would not be available to Wachovia as custodian (even though Wachovia provides the same services acting as custodian or as directed trustee). More critically, because

[13] See 69 Fed. Reg. 39707 and 39707 n.252. Wachovia continues to object to the Commission's interpretation that "order taking" is not within the scope the custody and safekeeping exemption under Exchange Act section 3(a)(4)(B)(viii). We believe that this interpretation directly conflicts with Congressional intent, as we previously noted to the Commission in comments. See Comments of First Union National Bank (July 13, 2001). See also Comments of the American Bankers Association on S7-12-01 (July 17, 2001). Given that bundled plan service arrangements were commonly used in 1999 and that Congress specifically added section 3(a)(4)(B)(viii)(ee) to provide relief to banks providing services to employee benefit plans, we believe that it is unreasonable to conclude that Congress intended to require banks to restructure and renegotiate their employee benefit plan services business. Further, the result of the Commission's interpretation's of section 3(a)(4)(B)(viii) will be detrimental rather than protective of plans and plan participants. To the extent that banks cannot offer order-taking as part of custody services, custody customers, including plans, will be required to open brokerage accounts with broker-dealers to effect securities transactions. This would be detrimental not only to banks, but to custody customers who will incur the extra cost of engaging another service provider to perform services that are currently provided by bank custodians.

Wachovia is compensated under bundled service arrangements for nearly all of its plan clients, Wachovia cannot satisfy the "chiefly compensated" test under the trust and fiduciary activities exception as it is currently interpreted by the Commission. Specifically, under proposed Rule 724, compensation received from mutual funds under a bundled service arrangement would be either "sales compensation" or "neutral compensation." Since Wachovia receives a relatively small percentage of its compensation directly from its plan clients, relatively little of its compensation will meet the definition of "relationship compensation."

Therefore, Wachovia welcomes the Commission's efforts to provide an exemptive rule to accommodate bank services to employee benefit plans by proposing Rule 770. Unfortunately, as proposed, Rule 770 will needlessly increase the complexity and cost of providing plan services, while providing little or no benefit to plans and plan participants. It will unduly restrict the availability of plan services that Wachovia and other banks customarily provide, which would be harmful to plans and participants impacted by these restrictions. It will force Wachovia and other banks to restructure most if not all of their plan service and compensation arrangements, solely to accommodate conditions under proposed Rule 770. Further, it will put Wachovia and other banks at a significant competitive disadvantage relative to competitors such as mutual fund complexes, broker-dealers and other non-bank service providers who will not be required to comply with proposed Rule 770's burdensome conditions and limitations. The disruption associated with these changes is likely to result in lost business for Wachovia and other banks, increased costs for plans, and may force Wachovia and other banks to stop providing some services to employee benefit plans.

None of these consequences of the conditions under proposed Rule 770 will benefit plans or participants. Moreover, the conditions proposed under Rule 770 are unnecessary in light of the extent to which banks are already regulated by ERISA and other laws in providing plan services.[14] Therefore, Wachovia urges the Commission to substantially broaden the relief provided by Rule 770. As discussed in more detail below, the Commission should revise proposed Rule 770 by eliminating the dollar-for-dollar offset condition, extending the rule to cover more types of plans, deleting the prohibition on incentive compensation for bank employees, and expanding the rule to cover transactions in other

[14] For plans where ERISA does not apply (e.g., governmental plans), state laws generally impose standards similar to standards under ERISA, in many cases even incorporating ERISA by reference. In addition, state trust and agency laws, which would generally apply if ERISA does not, impose limitations on compensation of trustees and custodians, including in particular limits on the amount and type of fees a trustee or custodian may receive from mutual funds. These laws may be as restrictive (or even more restrictive) as ERISA requirements and may include detailed disclosure requirements with respect to compensation received. See, e.g., Ariz. Rev. Stat. Ann. § 6-246; Cal. Fin. Code § 1561.1; Fla. Stat. Ann. §§ 660.417, 737.402(2)(e); 760 Ill. Comp. Stat. Ann. 5/5.2; Tex. Prop. Code Ann. § 113.053(g).

securities, including in particular, employer securities. These changes would accommodate Wachovia's current business practices with respect to employee benefit plan services. They also would be consistent with Congressional intent that Exchange Act amendments under the GLBA not disturb traditional trust and fiduciary activities and customary banking activities of banks.[15]

1. Eliminate the Offset/Credit Condition

Proposed Rule 770 would provide that a bank must offset or credit any "compensation"[16] that it receives from a fund complex related to securities in which plan assets are invested against fees and expenses that the plan owes to the bank. The Commission gives two reasons for this requirement. First, banks "advised the Commission staff that they offset or credit any compensation received from mutual funds against plan expenses."[17] However, as noted, Wachovia almost never performs a dollar-for-dollar offset of compensation received from fund complexes against plan fees. Our previous comments to the Commission communicated this.[18]

The Commission also states that a dollar-for-dollar offset would "address the conflict of interest that banks would otherwise have when choosing particular funds to offer to plan sponsors." As discussed in more detail below, this rationale does not support a dollar-for-dollar offset condition in light of relevant Labor Department guidance. Wachovia is not aware of any reports of widespread abuse in connection with banks receiving compensation from mutual funds for plan services. Moreover, the imposition of a dollar-for-dollar offset would be administratively burdensome and would disadvantage banks in competing with brokers-dealers, mutual fund complexes, and other non-bank service providers not required to perform the offset or credit when providing identical services to plans. Based on these concerns, which are discussed in more detail below, Wachovia believes that the dollar-for-dollar offset condition will not offer any benefits that will outweigh its costs, and should be eliminated.[19]

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[15] See S. Rep. No. 106-44 at 10 (Apr. 28, 1999) and Conf. Rep. 106-434 at 163-164 (Nov. 2, 1999).

[16] Although the term "compensation" in proposed Rule 770 is not defined, it appears to include any form of compensation, whether for distribution, shareholder services, or administrative, sub-transfer agency or other services, received from the mutual fund or fund complex. However, even if the term only means "sales compensation," as that term is defined in proposed Rule 724, Wachovia would still object to the offset or credit requirement for all of the reasons outlined in this letter.

[17] 69 Fed. Reg. 39718.

[18] See Comments of First Union National Bank on S7-12-01 (July 13, 2001).

[19] If the offset/credit condition is eliminated, the disclosure condition under proposed Rule 770(a) should (if not deleted altogether) be amended to reflect this change and to be consistent with Labor Department guidance. See infra Section C.5. for suggested amendment language.

a. Labor Department Guidance. In providing services to plans, banks are generally subject to the fiduciary responsibility and prohibited transaction provisions under ERISA.[20] The Labor Department has issued specific guidance that addresses the conditions under which banks and other plan service providers may be compensated by mutual fund complexes for providing plan services under DOL Advisory Opinion 1997-15A (May 22, 1997) (the "Frost Letter") and DOL Advisory Opinion 1997-16A (May 22, 1997) (the "Aetna Letter"). These opinions have been more recently supplemented by DOL Advisory Opinion 2003-09A (June 25, 2003) ("ABN AMRO Letter"), which provides similar guidance. Together, these advisory opinions establish a framework for determining whether a bank may retain compensation from mutual funds in connection with plan investments, or the bank must provide an offset or credit against plan fees.

Specifically, under this Labor Department guidance, whether or not a bank can receive and retain compensation from mutual funds depends upon whether or not the bank is or is not acting in a fiduciary capacity, either by virtue of its exercise of discretionary authority or control over plan assets or by virtue of providing investment advice, and whether or not the bank provides an independent plan fiduciary with sufficient information to allow the independent fiduciary to make informed decisions about the bank's compensation, including compensation received from mutual fund complexes. If a bank does not have or exercise fiduciary authority or control or provide investment advice, a bank may receive and retain compensation from mutual funds in connection with plan investment transactions without performing a dollar-for-dollar offset.[21]

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[20] Generally, ERISA regulates the conduct of plan "fiduciaries" as defined by ERISA section 3(21). Fiduciaries generally include persons exercising discretionary authority or control with respect to the management of plan assets or plan administration and anyone providing investment advice with respect to plan assets for a fee. Also, according to the Labor Department, trustees, including "directed trustees" are plan "fiduciaries." See 29 C.F.R. § 2509.75-8, D-3 (plan trustee is fiduciary by very nature of his position). Among other things, ERISA section 404 requires fiduciaries to act prudently, solely in the interest of plan participants and beneficiaries and according to governing plan documents. Prohibited transaction provisions under ERISA section 406 (and parallel prohibited transaction excise tax provisions under Code section 4975, which apply to all tax-qualified retirement plans) generally prohibit fiduciaries from causing plans to engaging in certain "prohibited transactions" between plans and parties in interest and transactions that may involve fiduciary self-dealing, conflicts of interest or "kickbacks" to a plan fiduciary, unless there is an applicable statutory or administrative exemption.

[21] In the Frost Letter, the Labor Department concluded that a bank serving as a directed trustee for plans would have or exercise authority as a plan "fiduciary" by assisting plans in selecting mutual funds as plan investment options and reserving the right to add, substitute and delete plan investment options. Because the Labor Department concluded that the bank's receipt of compensation from mutual funds could create conflicts for the bank in providing these services, the Frost Letter concludes that bank could receive compensation from mutual fund complexes in connection with the plan investment transactions only if the bank offset all compensation received from the mutual fund complexes on a dollar for dollar basis against other plan fees.. See DOL Adv. Op. 1997-15A. The

The Aetna Letter and ABN AMRO specifically address the Commission's concerns about conflicts banks may have in choosing funds to offer to plan sponsors. First, the Aetna Letter focuses on a recordkeeper's rights to make changes in a mutual fund menu and implies that decision-making about what investment options to include in the menu is not a "fiduciary" decision for ERISA purposes, so long as (a) the plan sponsor (or other independent plan fiduciary) receives sufficient information about the funds and the compensation the funds pay, and (b) that plan sponsor (or other plan fiduciary) is free to determine whether or not to accept or continue the services or to select a different service provider.

The ABN AMRO Letter addresses the issue even more directly. Specifically, under ABN AMRO's bundled services program, ABN AMRO is a directed trustee and provides plans a menu of mutual fund investment options, including proprietary and non-proprietary mutual funds. ABN AMRO would require, as a condition of entering into a services arrangement, that a potential client plan select at least one proprietary mutual fund (from which ABN AMRO or its affiliate would receive compensation). The Labor Department still determined that ABN AMRO's receipt of compensation from mutual fund complexes without a dollar-for-dollar offset was permissible because the plan sponsor or other appropriate plan fiduciary (i) would retain full authority and control over plan investments where the terms of the arrangement are fully disclosed, and (ii) was free to accept the terms or seek out a different service provider.

The Labor Department's analysis in the Frost, Aetna, and ABN AMRO Letters make it clear that the Labor Department has already reviewed and addressed the circumstances in which conflicts of interest should require banks to offset or credit compensation from mutual funds against other plan fees, including whether banks have a conflict of interest when choosing particular funds to offer to plans. Where banks comply with this Labor Department guidance, including the disclosure required by this guidance, additional regulation under Commission rules should not be necessary. In this regard, ERISA remedies and penalties for breach of fiduciary duties provide significant deterrents to breach of disclosure and other

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Aetna Letter concludes, on the other hand, that a plan recordkeeper may receive fees from mutual fund complexes without a dollar for dollar offset, where the recordkeeper offers a "menu" of mutual fund investment options from which a plan sponsor (or other independent plan fiduciary) selects plan investment options <u>and</u> the recordkeeper reserves the right to make changes to the menu. The difference between the bank in the Frost Letter and this recordkeeper is that, based on the recordkeeper's procedures for disclosing fees received from mutual funds and making changes in the mutual fund menu, the Labor Department concluded that the recordkeeper would <u>not</u> act as a plan "fiduciary" by exercising its right to add, delete or substitute funds on the menu. Key to this outcome is that an independent plan fiduciary would retain full authority and control over plan investments where the recordkeeper's compensation arrangements with the mutual fund complexes were disclosed, and the plan fiduciary would be free to decide whether to accept a fund menu change or take the plan business elsewhere. <u>See</u> DOL Adv. Op. 1997-16A.

fiduciary obligations by banks.[22] Moreover, other Labor Department guidance further suggests that a bank's failure to provide sufficient information to enable a plan sponsor or other plan fiduciary to determine whether a bank's compensation is appropriate may be enough to cause a bank to violate ERISA's prohibition against self-dealing.[23]

b. Administrative Burdens. Because of the Labor Department rulings described above, Wachovia and other banks have structured their fee and service arrangements to reduce, and in most cases entirely eliminate, the amounts charged to and paid directly from plans under bundled service arrangements. Instead, fees for plan services are paid indirectly through amounts paid from mutual fund complexes, under conditions that comply with ERISA's fiduciary responsibility provisions. Importantly, plan sponsors and other plan fiduciaries commonly seek out these arrangements for several reasons. Specifically, the fee arrangements are simpler in that there is no need to allocate and collect plan service charges from participant accounts. This eliminates the need to make complicated and confusing disclosures to participants about fees that are charged to their accounts and then offset by amounts paid by the mutual fund complexes. These arrangements also allow plan fiduciaries and participants to evaluate plan investment returns on a net asset value basis, which takes into account most, if not all, plan administrative costs.

The offset/credit condition under proposed Rule 770 would eliminate the administrative advantages of bundled service arrangements and create several administrative

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[22] ERISA section 409 requires any fiduciary breaching a fiduciary duty to make the plan whole for any losses including lost investment earnings and to disgorge any profit (including excess compensation received by a fiduciary). Actions for breach of fiduciary duty may be brought by any plan fiduciary, plan participant, or the Labor Department. In addition, fiduciaries and other "disqualified persons" receiving excess compensation could violate prohibited transaction excise tax provisions under Code section 4975 (which are substantially similar to the prohibited transaction provisions under ERISA section 406). Generally, a prohibited transaction must be corrected by, in the case of excess compensation, repaying the excess compensation to the plan. Code section 4975 also imposes on the disqualified persons self-assessing excise taxes of 15% of the "amount involved" in a prohibited transaction each year until the prohibited transaction is corrected. If the transaction is not corrected and excise taxes paid before the Internal Revenue Services brings action to force correction and collect the excise taxes, the tax could be 100% of the amount involved.

[23] In Field Assistance Bulletin 2002-3 (Nov. 5, 2002), the Labor Department explains that plan service providers, including banks acting as directed trustees or custodians, are required to disclose to plan customers sufficient information about their compensation so that their customers can reasonably approve plan service arrangements based on an understanding of the service provider's compensation. This concept of "full and fair" disclosure is intended to ensure that a plan service provider's compensation is determined and approved by a plan fiduciary independent of the service provider. Service providers that fail to provide sufficient disclosure could be deemed to be exercising control of their own compensation from the plan. This exercise of control could make the service provider a fiduciary under ERISA section 3(21), and at the same time, result in prohibited self-dealing by the service provider.

problems. First, Wachovia does not currently have automated processes to implement a dollar-for-dollar offset. In the rare cases where it does perform a dollar-for-dollar offset for a plan, Wachovia employs a complex manual process that cannot be used for more than a few plan clients.

Automated systems and processes for administering the dollar-for-dollar offset would be essential given the large numbers of plans Wachovia services, the fact that each plan invests in several different mutual funds, and that plans also may invest in different share classes that pay different levels of compensation. Also, Wachovia typically holds custody of plan assets invested in mutual funds in "omnibus" level accounts, and receives compensation from mutual fund complexes based on value of these omnibus accounts rather than for particular plan balances. Allocating compensation received from mutual funds in respect of these omnibus accounts would further complicate the administration of a dollar-for-dollar offset requirement. Wachovia will also have to adopt new administrative processes for maintaining plan participant account records in order to collect fees from participants' accounts if compensation paid by mutual funds is not sufficient to offset plan fees. This also will require additional communication to plan participants about fees charged to their participant accounts. Wachovia would incur significant costs to develop and implement automated systems and processes to administer a dollar-for-dollar offset and to communicate the extra fees to participants. Plans and plan participants will bear at least some of these costs.

The mechanics of fee offset/credit arrangements are complicated and raise technical issues under ERISA's prohibited transaction rules. In this regard, compensation paid from mutual fund complexes can be delayed substantially after the time at which the plan is making investments in mutual funds and receiving the services. Thus, a bank that delays collecting plan service fees otherwise due to be paid by a plan may be extending credit to the plan. ERISA section 406(a)(1)(B) generally prohibits extensions of credit between plans and parties in interest, including plan service providers. Addressing these issues makes the dollar-for-dollar offset requirement even more administratively burdensome and is one of the reasons why banks generally structure their fees and services to avoid dollar-for-dollar offset fee arrangements.

Wachovia also would be required to renegotiate its service and compensation agreements with plans to implement a dollar-for-dollar offset. Specifically, Wachovia and the plan would have to agree on the total fees the plan should pay for services, and the plan would be obligated to pay the stated fee.[24] Generally, Wachovia may charge plans more for

[24] It also should be noted that, under the new agreements that would be required if the offset/credit condition is imposed, plans and plan participants (rather than Wachovia) would bear the risk of whether compensation paid by mutual fund complexes will entirely offset plan service costs. If the compensation amount from fund complexes is not sufficient, plans and plan participants would be "stuck" with the remaining fees and the remaining fees would have to be allocated and charged to participant accounts. Under current arrangements, plan sponsors generally require Wachovia to agree

these services if the plan is paying the expenses directly, as compared to arrangements where the plan sponsor or other plan fiduciary forces Wachovia to limit its compensation to amounts that are available from mutual fund complexes. The renegotiation of plan service agreements to state specific fees, building new systems capabilities to administer the offset/credit requirement, and communicating new plan level fees to participants will increase the complexity of plan fee arrangements and overall costs compared to the bundled service arrangements available to plans today. Moreover, the possibility of new plan level fees may discourage or prevent some plan sponsors (especially plan sponsors who are small-sized employers) from offering retirement savings opportunities to their employees.

The retirement plan services industry has already had substantial experience with the problems of dollar-for-dollar offset compensation arrangements. In fact, these various administrative issues were an important reason why the bundled service compensation model is so commonly offered to plans and typically requested by plan sponsors and plan fiduciaries. By imposing a dollar-for-dollar offset condition under proposed Rule 770, the Commission would be regulating the terms of contracts established between Wachovia and its plan customers, something Congress surely did not intend. Moreover, in regulating these contracts, the Commission would be forcing banks and plans to return to a service model that has been rejected by retirement plan service providers and by plan sponsors or other fiduciaries that select plan fee and service arrangements. This would set banks years behind their competitors who would not be required to perform a dollar-for-dollar offset.

c. Competitive Concerns. Wachovia and other banks already compete with broker-dealers, mutual fund complexes and other non-bank service providers to offer bundled services to plans. Requiring banks to perform a dollar-for-dollar offset where broker-dealers and mutual fund complexes are not subject to the same requirements would put banks at a substantial competitive disadvantage. In this regard, while Congress intended to "level" the playing field between banks and broker-dealers where the bank exception from broker-dealer registration created competitive disparities, it does not appear that Congress intended to put banks at a competitive disadvantage to broker-dealers. In particular, one reason given by Congress for the functional exceptions provided by Exchange Act section 3(a)(4) is that conditions relating to excepted activities "are tailored to protect investors and to ensure the competitive fairness among different types of financial services providers."[25] In the case of employee benefit plans, regulation under ERISA (or similar laws where ERISA does not apply) already ensures competitive fairness by imposing the same legal requirements on all plan service providers.

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to limit its plan service fees to amounts received from mutual fund complexes, so that participants are not generally subject to any account level charges.

[25] H.R. Rep. No. 106-74, pt. 4 at 162 (1999). The Commission cites this language in its discussion of proposed Regulation B. See 69 Fed. Reg. at 39684, n.16.

According to the Commission, this credit/offset requirement would benefit plans and plan participants because, as investors, they need to know about the fees associated with their investments because these fees directly affect their investment returns and information about fees should be transparent to "purchasers of ERISA plans so that they can make 'apples to apples' comparisons."[26] However, imposing an offset/credit requirement on banks would not mean that plan sponsors and other plan fiduciaries would be able to make "apples to apples" comparisons so long as banks' competitors, including broker-dealers and mutual fund complexes, could continue to offer bundled service arrangements without a dollar-for-dollar offset. Comparing two such disparate fee structures would be complex and burdensome for plan sponsors and other plan fiduciaries.

Importantly, since Wachovia provides plan sponsors (or another appropriate named fiduciary of a plan) information about the compensation it receives from mutual fund complexes, plan sponsors and other plan fiduciaries can evaluate whether the services the plan receives are appropriate given the compensation paid by mutual fund complexes. The bundled service industry is highly competitive, with all providers, including Wachovia, competing to provide a high level of services to plans and plan participants. In fact, there has already been substantial industry consolidation and some plan service providers are exiting the business because they cannot compete. Wachovia believes that, given the high level of specialized plan recordkeeping, administrative and other services that it provides to plans under bundled services arrangements, its compensation from mutual fund complexes for these services is appropriate and reasonable. If forced to perform a dollar-for-dollar offset, Wachovia would be forced to directly charge the plan at least the same fee that plans currently pay indirectly through mutual funds, or more likely, additional fees to reflect its increased costs to implement and administer the dollar-for-dollar offset. Therefore, the credit/offset condition could result in plans paying more for plan services. In an industry that is already highly competitive, this is another reason why proposed Rule 770 would put Wachovia and other banks at a competitive disadvantage relative to other service providers not subject to similar limitations.

Therefore, proposed Rule 770's offset or credit requirement would create new competitive disparities among banks, registered broker-dealers and mutual fund complexes. Broker-dealers and mutual fund complexes would not be required to offset mutual fund compensation against plan fees on a dollar-for-dollar basis and could continue to offer bundled service arrangements to plans. On the other hand, Wachovia and other banks would be forced to offer a plan service model that has generally been rejected by plan sponsors and other plan fiduciaries. This result would be unfair to banks and could ultimately remove banks as effective competitors in the employee benefit plan services industry. The resulting reduction in competition would be harmful to plans and plan participants, and could result in plans paying more rather than less for plan investment management and plan administrative services.

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[26] 69 Fed. Reg. at 39718.

In this context, and in light of industry disruption that would result from imposing the dollar-for-dollar offset condition and the potential harm this condition may cause to plans and plan participants, Wachovia believes that the dollar-for-dollar offset condition should be eliminated from proposed Rule 770.

2. Rule 770 Should Cover All Plan Types

Rule 770 as proposed would only apply when banks provide services to qualified plans under Code sections 401(a), 403(b), or 457. However, as noted, Wachovia provides services to other types of plans, including VEBAs, church plans described by Code section 414(e), governmental plans described by Code section 414(d), and non-qualified deferred compensation plans. Wachovia provides services to these types of plans together with the tax-qualified retirement plans already covered by proposed Rule 770, using the same trust administration and recordkeeping systems and following the same procedures. Most of these types of plans also are subject to ERISA or to similar regulatory schemes that protect the plans and participants.

There is no reason to omit these other plans from coverage by proposed Rule 770. Moreover, regulatory distinctions among different types of plans will be extremely disruptive to plan sponsors. If these plans are subject to different regulatory requirements, Wachovia would be required to restructure its services to support these plans, which would increase the complexity in providing services to all types of plans. For some types of plans, the changes will be too costly and Wachovia may exit the service business for that type of plan. Therefore, Wachovia requests that the Commission expand proposed Rule 770 to cover these other types of plans.

3. Rule 770 Limits on Incentive Compensation Should be Deleted

Wachovia, like many other banks, offers an incentive program to employees for obtaining new trust and custody clients, including employee benefit plans. Under this program, some employees are compensated based on the total new revenue received by Wachovia from employees' marketing of trust and custody products and services. The "total revenue" considered for this purpose could include all fees that plan clients are expected to pay directly or indirectly to Wachovia, including amounts that Wachovia receives indirectly from mutual fund complexes. Importantly, a number of facts and circumstances are critical to the "total revenue" calculation, including the type of plan, plan size and the types and level of services that will be provided. Any fees paid by the plan directly are treated the same as the compensation that Wachovia receives indirectly from mutual fund complexes.

Proposed rule 770(a)(4) would prohibit a bank from relying on Rule 770 unless the bank does not "pay any incentive compensation to a natural person that is not qualified pursuant to the rules of a self-regulatory organization that differs based on the value of a security purchased or sold by an account or a person who exercises control over the assets of such account."[27] The Commission's comments indicate that the intent of this condition is that unregistered employees of the bank should not have a "salesman's stake" with respect to securities transactions.[28]

This condition would unnecessarily interfere with the incentive compensation program Wachovia has historically offered to its employees. Wachovia's compensation program is not designed and does not operate to create a "salesman's stake" in plans' securities transactions. In fact, the fees that plans pay directly are given the same weight as amounts received indirectly from mutual fund complexes. Therefore, the program only compensates employees for obtaining new clients, including employee benefit plan clients, that engage Wachovia to provide the trust, custody and other plan products and services described above. Therefore, there is no reason for the Commission to interfere with this program.

Further, imposing limits on bank employees' compensation programs such as the program offered by Wachovia will not provide better protections to plans as investors. In this regard, the reasonable compensation and other conditions that apply under ERISA and similar state laws in the context of employee benefit plan services already require Wachovia to carefully supervise and train employees marketing bank services to employee benefit plans. If a Wachovia employee provides specific investment recommendations that result in "investment advice" for ERISA purposes in the marketing process, Wachovia could be deemed to be an ERISA fiduciary to a plan as a result of the employee's activities. This might trigger requirements under ERISA to perform a dollar-for-dollar offset of compensation received from mutual funds under Labor Department interpretations described above.[29] In addition, misconduct by the employee (including any "imprudent" investment advice) could subject Wachovia to potential liability for breach of fiduciary duty under ERISA. Thus, new Commission restrictions on Wachovia's employees are not necessary to protect plans and plan participants.

Finally, as drafted, the prohibition on incentive compensation described by proposed Rule 770(a)(4) is ambiguous and unnecessary. The phrase "purchased or sold by an account or a person who exercises control over the assets of such account" is confusing. Also, the language is ambiguous about whether compensation under the section 3(a)(4)(B)(i) networking exception is permitted. There is no reason to bar banks from paying their employees pursuant to that exception where the applicable conditions are satisfied or to bar dually-registered employees from receiving compensation for brokerage transactions.

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[27] 69 Fed. Reg. at 39738.

[28] See 69 Fed. Reg. at 39719.

[29] See the Frost Letter and other authorities discussed above in Section C.1.

Therefore, Wachovia requests that the Commission delete the prohibition on incentive compensation under proposed Rule 770(a)(4). However, if the condition is retained, it should be revised to clarify that it does not prohibit programs that provide employee bonuses or other benefits based on the total of fees or other compensation generated by new clients, or incentive compensation relating to brokerage transactions paid pursuant to a networking arrangement meeting conditions under section 3(a)(4)(B)(i). Specifically, proposed Rule 770(a)(4) should be revised to read as follows:

> The bank does not pay any incentive compensation that differs based on the value of a security or the type of security purchased or sold by a plan to any natural person that is not qualified pursuant to the rules of a self-regulatory organization, provided that this condition does not prohibit:
>
> (i) a bank from paying its employees compensation under a bonus or other incentive program based on the bank's total compensation for services to one or more plans, including any such compensation received indirectly through payments from mutual fund complexes, or
>
> (ii) any compensation paid pursuant to a networking arrangement that meets the conditions of section 3(a)(4)(B)(i) of the Securities and Exchange Act of 1934 (15 U.S.C. 78c(a)(4)(B)(i); and

4. Relief for Other Securities Transactions, Including Employer Securities

As proposed, Rule 770 only applies where banks effect transactions in mutual funds or offer participant-directed brokerage accounts. Even though Wachovia's clients invest primarily in mutual funds, these plans sometimes purchase other securities and may request Wachovia to effect these transactions as an accommodation. This is particularly true for plans that invest in employer securities. In this regard, employer securities in a plan may be managed by the plan sponsor or another plan fiduciary, or may be offered as a plan investment option to plan participants. Plan sponsors or other plan fiduciaries expect that Wachovia will be able to effect these transactions, usually through a broker-dealer that they designate.

Many plans (whether or not they are participant-directed) invest in employer securities and the assets held by plans in employer securities are significant. If Wachovia cannot provide services with respect to employer securities and other securities owned by a plan, plan sponsors or other plan fiduciaries would be forced to open separate brokerage accounts with a broker-dealer to effect these plan transactions. This would increase plan expenses for effecting plan transactions in employer securities and create additional administrative issues.

Exchange Act section 3(a)(4)(B)(iv)(I) would allow a bank to effect transactions in issuer securities as part of any pension, retirement or other similar benefit plans maintained for employees of an issuer, but only "as part of its transfer agency activities." However, Wachovia's business unit providing transfer agency services is separate from its retirement plan service business unit. If Wachovia performs transfer agency services to a securities issuer that also is the plan sponsor of an employee benefit plan receiving plan services, it would only be coincidence. Therefore, Wachovia cannot rely on this exception.

Therefore, Wachovia requests that the Commission expand Rule 770 to cover the effecting of transactions in any type of securities for employee benefit plans, or at least, to cover employer securities, subject to the condition already provided by proposed Rule 770(a)(5) (i.e., the bank complies with Exchange Act section 3(a)(4)(C), which would generally require the bank to direct the trades to a registered broker-dealer for execution). This change would accommodate the current business practices of Wachovia and other banks providing plan services while still protecting plans as investors. Without this change, Wachovia could be forced to stop providing services that plan sponsors and other plan fiduciaries expect to receive from their plan trustees and custodians, and plans will incur additional expense in seeking these services through a broker-dealer.

5. Eliminate the Disclosure Condition

As discussed, Wachovia and other banks are already required to disclose the compensation they receive from mutual fund complexes under detailed guidance issued by the Labor Department. Therefore, the disclosure condition under proposed Rule 770(a)(2) is unnecessary and should be deleted.

However, if it is retained, it should be revised because it is unclear in requiring disclosures to be made to "the plan sponsor, or its designated fiduciary" and these terms are not defined. Generally, ERISA requires that a plan "fiduciary" review plan services and fee arrangements and determine that the arrangement is appropriate and compensation is reasonable. This fiduciary may be the plan sponsor or may be another person designated under the plan's terms. Accordingly, Wachovia suggests that the Commission clarify that the appropriate person to receive the disclosure is the "plan sponsor or other person designated to review and approve plan service arrangements." To address this comment and the proposed deletion of the offset/credit condition under proposed Rule 770(a)(1), proposed Rule 770(a)(2) (if not deleted altogether) could be revised to read as follows:

> The bank provides a clear and conspicuous disclosure to the plan sponsor or other person designated to review and approve plan service arrangements that includes all fees and expenses assessed for services provided to the plan and all compensation received or to be received from a fund complex in respect of the plan's investments in a manner that

> provides such person sufficient information to determine whether amounts paid by the plan for the bank's services are reasonable.

6. Other Clarifications of Proposed Rule 770(a)

In proposing Rule 770, the Commission explains that banks serving as "trustees and non-fiduciary administrators" may rely on the exemption.[30] Proposed Rule 770 is not consistent with this statement because it would only provide an exemption where a bank acts as "trustee or custodian, or offers participants a participant-directed brokerage account . . ..".[31] Wachovia requests that the language of Rule 770 be revised to be consistent with the Commission's intent, by exempting banks acting as "trustee, custodian, or other plan service provider."

Wachovia also notes that it is confusing for the rule to state that a bank "offers" plan participants participant-directed brokerage accounts, as indicated by language under proposed Rule 770(a) and 770(a)(3). Generally, banks provide services in connection with participant-directed brokerage accounts if the plan is designed to allow participants to direct investments for their individual employee benefit plan accounts through a self-directed brokerage option under the plan, or if the plan sponsor or other plan fiduciary concludes that it is prudent to allow participants the opportunity to select additional investment options through a participant-directed brokerage option. Accordingly, proposed Rule 770 should be revised so that the word "offer" is not used and instead banks are characterized as providing services in connection with participant-directed brokerage accounts.

To reflect these comments and other comments above relating to the types of plans that should be covered and the need to cover other types of securities, the Banks suggest that the language under proposed rule 770(a) should be revised and additional definitions added to the proposed rule. Specifically, the language of rule 770(a) could be revised to read as follows:

> A bank is exempt from the definition of the term "broker" under section 3(a)(4) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(4)) to the extent that it effects transactions in any securities, including without limitation securities of an open-end company or employer securities or provides services with respect to a participant-directed brokerage accounts in an account for a plan for which the bank acts as a trustee, a custodian, or other service provider, if:

In addition, the following new definitions could be added:

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[30] 69 Fed. Reg. at 39718.

[31] 69 Fed. Reg. at 39737 (proposed Rule 770(a)).

> *Employer securities* means a security issued by an employer of employees covered by a plan, or by an affiliate of such employer.
>
> *Plan* means (i) a plan that is qualified under section 401(a) of the Internal Revenue Code of 1986, as amended (the "Code"), (ii) a plan described in section 403(b) of such Code, (iii) a church plan described by section 414(e) of such Code, (iv) any governmental plan described by section 414(d) of such Code (including governmental plans described by section 457 of such Code), (v) any voluntary employee benefit association established under section 501(c)(9) of such Code and any other trust or fund maintained by an employer for purposes of funding a welfare benefit plan subject to title I of the Employee Retirement Income Security Act of 1974, as amended (ERISA), and (vi) any account maintained by an employer in connection with an unfunded plan under which employees' receipt of certain compensation from the employer is deferred.

III. Conclusion

Wachovia appreciates that the Commission in proposed Regulation B has sought to be accommodative of banks' current business processes with regard to their trust and fiduciary activities. Unfortunately, the proposed rules relating to the trust and fiduciary exception are unduly burdensome to and disruptive of banks' normal, authorized business practices. Wachovia strongly believes that it should continue to be able exercise its trust and fiduciary authority as prescribed by the National Bank Act and as regulated by the OCC, Wachovia's functional regulator, in a manner that allows Wachovia competitively to deliver authorized trust and fiduciary products and services within a business model that is adaptable to organizational and market dynamics. Further, Wachovia also strongly submits that any chiefly compensated test should be limited to a comparison between what the Commission determines to be sales compensation and total compensation received for conducting activities within its trust and fiduciary powers. This will achieve the functional regulation goals of Congress implemented by the passage of GLBA, while also maintaining banks' abilities to continue conducting trust and fiduciary activities that are supervised and regularly examined by the federal banking regulators without undue cost or regulatory oversight.

Wachovia also commends the Commission for recognizing that accommodations are needed to avoid disrupting the services that Wachovia and other banks provide to employee benefit plans. Unfortunately, proposed Rule 770, if implemented, will not accommodate Wachovia's current business practices. Instead, it would require costly and burdensome changes in the services that Wachovia provides to employee benefit plans by forcing Wachovia to restructure its services and renegotiate plan service agreements, imposing new administrative processes, and possibly, stopping some services that plans count on Wachovia to provide. It would mean increased costs and complexity for Wachovia's clients and would put Wachovia at a significant disadvantage in competing with broker-dealers and mutual fund complexes providing similar plan services.

We believe that none of these consequences are necessary, particularly since they will not provide better investor protections to plans and participants. Therefore, Wachovia urges the Commission to broaden the relief provided by proposed Rule 770 by (i) eliminating the credit/offset condition and related disclosure condition, (ii) expanding the types of plans covered by the rule, (iii) eliminating the prohibition on incentive compensation for bank employees, and (iv) expanding the rule to allow banks to effect transactions in securities in addition to mutual funds, including employer securities.

Thank you for the opportunity to provide these comments. Wachovia would be pleased to discuss the comments made in this letter in more detail. If you have any questions, please contact me.

Very truly yours,

Michael A. Watkins

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