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Securities and Exchange Commission
450 5th Street, N.W.
Washington, D.C. 20549-0609

Attention: Mr. Jonathan G. Katz, Secretary

Re: Release No. 34-49879 (File No. S7-26-04): Regulation B

Ladies and Gentlemen:

JPMorgan Chase & Co. ("JPMorgan Chase") is writing to comment on the various rules proposed to be adopted (the "Proposed Rule") by the Securities and Exchange Commission (the "Commission") under the Securities Exchange Act of 1934 (the "Exchange Act") as modified by the Gramm-Leach-Bliley Act ("GLBA"), and that are proposed to be contained in a new Regulation B.

JPMorgan Chase has participated actively in drafting the letter submitted by The Clearing House Association L.L.C. (the "Clearing House") and strongly endorses that letter's comments regarding the Proposed Rule, both with respect to technical aspects of the Proposed Rule and the Proposed Rule's inconsistency with the literal terms of GLBA and its legislative history. JPMorgan Chase agrees that the rules are unnecessarily complex and impose on banks substantial operational and compliance burdens to enable them to qualify for what JPMorgan Chase believes are clear statutory exemptions. Additionally, we note that many of these rules are likely to impose additional burdens on bank customers without achieving commensurate cost-savings, customer protections, or any other benefits to customers. JPMorgan Chase urges the Commission to issue a final Regulation B which is consistent with GLBA. We believe that this can be done in a manner that also gives effect to the Congressional mandate that true brokerage activities be performed in a broker-dealer.

Because of the comprehensiveness and quality of the Clearing House letter, this letter will focus on those issues which are particularly important to JPMorgan Chase.

Employee Compensation for the Referral of a Customer to a Registered Broker or Dealer

Bonus Plans

JPMorgan Chase is deeply concerned about the discussion in the Release regarding bonus plans. We believe that the Commission's assertion of jurisdiction may require financial institutions to overhaul bonus programs, causing disruption, expense, and confusion in vast areas of the business that bear little relation to the referral programs governed by the networking exception, except that they might draw from a common pool of bonus money.

The release accompanying the Interim Final Rules stated that "by their very nature [bonus plans] are incentive compensation" and then went on to state that unregistered bank employees may not "receive incentive compensation for any brokerage-related activity" other than permissible referral fees.1 According to that release, only bonus plans based on the overall profitability of the bank were permitted.

The Commission's discussion of bonus plans presents many problems for banks. Many bonus plans are discretionary, based on the judgment of the individual's manager. As a result, a number of intangible factors contribute to whether an individual earns a bonus. The Commission's expansive language can be read to apply to these discretionary plans, regardless of whether an individual or a line of business is charged with making referrals under a networking arrangement. For example, the discussions in the Release and in the release accompanying the Interim Final Rules raise the question whether the chief executive officer of a diversified financial services firm that has a broker-dealer subsidiary could receive a bonus that is based in part on the revenues generated by the broker-dealer.

In addition, few, if any, bonus plans are based solely on the stand-alone profitability of a bank or of a bank holding company, although that is one component of many plans. The Proposed Rule would result in the Commission's taking jurisdiction over bank and holding company bonus and other compensation plans, a matter that we believe is within the jurisdiction of the bank regulatory agencies. We believe that the legislative history of GLBA demonstrates that Congress did not intend the term "incentive compensation" to apply to normal company-wide or line of business bonus plans.

JPMorgan Chase urges the Commission to reconsider its position on bonus plans. Specifically, we recommend that the Commission take the position that bonus plans used as a conduit to pay brokerage-related compensation to unregistered employees under the exception are prohibited.2 We recognize that the Commission has rejected this interpretation, but we believe this gives effect to the statutory limitation on "incentive compensation" without unduly interfering with bank activities.

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1 66 Fed. Reg. 27,760, 27,766 (2001).

2 69 Fed. Reg. 39,689-39,690 (2004).

If the Commission chooses to regulate any bonus pool that includes or reflects revenues from a broker-dealer, then we urge the Commission to limit the application of this rule to individuals operating under the networking exemption only. If the Commission opts to regulate an entire firm's bonus plans, then the reach of this regulation must extend beyond the banking industry and should be applied to the entire financial services industry. Therefore, we believe that, to the extent the Commission adopts rules that apply to firm bonus plans broadly, the Commission should adopt a general rule applicable to any legal entity with broker-dealer revenues, as opposed to discussing this point in a release accompanying proposed rules that apply only to banks.

Referral Fees

Cash Compensation (Proposed Rule 710(b)(1))

JPMorgan Chase believes that the Proposed Rules' definition of the "nominal one-time cash fee of a fixed dollar amount" that a bank may pay an unregistered bank employee for the referral of a customer to a broker-dealer under the networking exception3 as part of Proposed Rule 710(b) reflects an unduly restrictive view of that term. JPMorgan Chase believes that it is possible for the Commission to achieve its objective of limiting incentives to unregistered bank employees for referrals of investment products while at the same time adopting more flexible, less burdensome definitions of "nominal."

Proposed Rule 710(b)(1)(i) permits a referral fee that does not exceed "the employee's base hourly rate of pay." This definition does not provide adequate flexibility to structure appropriate networking arrangements, particularly when multiple products, including credit, deposit and other non-investment products, are part of a compensation program. We recognize that the Commission seeks to ensure that unregistered people have no "salesman's stake" in investment activities. We respectfully believe that an individual could be compensated more than one hour of wages and not feel a "salesman's stake." We believe that the better measure of whether an employee has a "salesman's stake" is that the compensation for referrals be no more than the compensation received for referrals of other non-investment products.

JPMorgan Chase supports the Clearing House's proposal that banks be at least permitted to pay referral fees based on the following formula: an unregistered employee would be eligible to receive referral fees per referral that are based on a fraction of that employee's total annual compensation. JPMorgan Chase believes that this proposal more effectively addresses the definition of "nominal," and allows for greater flexibility.

JPMorgan Chase believes that the definition of "nominal" is unnecessarily rigid, making it difficult to structure compliant compensation plans. For example, we note that employee turnover rates in retail branches can be high, in the range of 25% to 40% per annum. It would be tremendously burdensome to attempt to calculate, and continually maintain and update,

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[3] Section 3(a)(4)(B)(i) of the Exchange Act.

individual rewards based on a specific employee's salary in lines of business where bank employees frequently change or leave positions.

Similarly, JPMorgan Chase believes that the $25 limit in the second prong of the definition of "nominal" in Proposed Rule 710(b)(1)(ii) is inadequate. The flat $25 limit in Proposed Rule 710(b)(1)(ii) is easier to administer for banks, and may therefore be preferred by institutions or lines of business that favor administrative simplicity over flexibility. We believe that Proposed Rule 710(b)(1)(ii) should be revised to be available to banks paying referral fees to various types of bank employees, whether tellers or higher-level employees. Although the $25 limit may be appropriate for tellers, it may be insufficient for personnel who are more highly compensated and who hold greater responsibility. We therefore request that Proposed Rule 710(b)(1)(ii) be revised to provide at least for a two-tier limit on this flat fee limit. We suggest that the limit would remain $25 for referrals made by tellers and the limit for referrals made by more highly compensated employees would be at least $50.

Non-cash Compensation (Proposed Rule 710(b)(3))

The definition of "nominal one-time cash fee of a fixed dollar amount" as applicable to a referral fee paid other than in cash does not appear to be workable.

We are concerned with the requirement in Proposed Rule 710(b)(3)(iii) that referral fees paid other than in cash be paid "under an incentive program that covers a broad range of products and that is designed primarily to reward activities unrelated to Securities" (emphasis added). This requirement is too vague. What is the definition of "primarily"? Is a compensation program compliant if investments are one of a few products in the program? JPMorgan Chase believes that this requirement creates potential uncertainty for banks as to whether they will be in compliance. We recommend that Proposed Rule 710(b)(3)(iii) be amended so that referral fees paid other than in cash may be paid under an incentive program that "covers a broad range of products and that is not designed to evade the restrictions on paying referral fees."

Proposed Rule 710(b)(3)(i) requires that such referral fees have a "readily ascertainable cash equivalent." According to the Release, this means that the "value or potential value [of the referral fee] must have been known by the bank and the employee at the time of the referral."[4] This is not, however, something that banks or their employees always will be able to accurately assess at that time. Accordingly, this requirement could effectively prevent banks from paying their employees referral fees other than in cash.

In addition, we observe that current industry non-cash compensation plans tend to be highly complex and formulaic. Such formulas tend to reward overall activity by an unregistered banker relating to a variety of products rather than applying points for each referral that can be assigned a "readily ascertainable value." In addition, non-cash compensation plans tend to require that a banker meet specific thresholds for a variety of products, and may apply points for various additional intangible factors, such as teamwork, before arriving at a final compensation

[4] 69 Fed. Reg. 39,688 (2004).

figure for an individual. As a result, it is very difficult for a non-cash compensation plan to determine a "readily ascertainable cash equivalent" for a specific referral.

The impact of Proposed Rule 710(b)(3) is likely to require restructuring of many compensation programs – not because the programs currently award more than nominal amounts but because of the difficulty of demonstrating that this requirement is met under current programs. We therefore propose that Proposed Rule 710(b)(3)(i) be amended so that such fees may be paid "in units of value that can be assigned a nominal cash value equivalent through a formula or other means after the payment period has passed."

Definition of "One-Time" (Proposed Rule 710(b)(2))

As mentioned above, Section 3(a)(4)(B)(i)(VI) of the Exchange Act limits the networking exception to payment of a "nominal one-time cash fee of a fixed dollar amount" (emphasis added). JPMorgan Chase disagrees with the Commission's interpretation of the term "one-time." Proposed Rule 710(b)(2) provides that a bank employee may receive a referral fee "no more than one time for each customer referred by that employee." The Release explains this requirement further by stating that "a bank could not pay a particular employee more than one referral fee based on multiple referrals of the same customer, and an unregistered bank employee who referred a customer more than once could receive only one fee related to that customer."[5]

Applying this "one-time" requirement on a per customer, rather than per referral basis, creates administrative difficulties and uncertainty as to compliance. Banks would have to create records tracking the identity of referred customers. Because payment of a referral fee may not be contingent on whether the referred customer opens an account at the broker-dealer, these records would necessarily be distinct from broker-dealer records, if any, that track accounts opened through referrals by bank employees.

Moreover, the Proposed Rule is silent as to the way in which banks will have to monitor compliance with this added restriction. For instance, there is no indication as to how long the prohibition on paying a referral fee to an employee for referring the same customer would last. Consider the following hypothetical: an employee refers a customer to an affiliated broker-dealer. The customer meets with the broker-dealer but does not open an account. Two years later, the same customer's economic circumstances have changed, and the employee again refers the customer to the broker-dealer. In a situation like this one, we firmly believe that it is not inconsistent with the "one-time" requirement in the GLBA to allow a bank to pay a second referral fee to the bank employee.

Definition of "Contingent on Whether the Referral Results in a Transaction" (Proposed Rule 710(a))

JPMorgan Chase considers the Proposed Rule's new definition of "contingent on whether the referral results in a transaction" an improvement especially insofar as Proposed Rule 710(a) provides a safe harbor for basing the payment of a referral fee on whether a customer contacts or keeps an appointment with a broker-dealer as a result of the referral; and on whether the referred

[5] Id. at 39,689.

customer meets certain generally established requirements regarding assets, income or net worth that the bank or broker-dealer may have established for payment of referral fees.

The Release asks whether "banks should be able to condition the payment of referral fees on other criteria relating to other aspects of a customer's financial profile, such as tax bracket."[6] We see no reason why they should not. Proposed Rule 710(a)(2) allows a referral fee to be contingent on whether the referred customer has income that meets a predetermined threshold. Because an individual's tax bracket is based on that individual's income, we interpret Proposed Rule 710(a)(2) to permit banks to condition payment of a referral fee on such a criterion.

Referral of Certain Corporate, Institutional, Governmental and Not-For-Profit Customers: Proposal by the Clearing House for Non-Nominal Referral Fees

JPMorgan Chase endorses the Clearing House's proposal to the Commission's Division of Market Regulation by letter dated April 16, 2004, for an exemption that would allow banks to pay higher than "nominal" referral fees to unregistered bank employees for the referral of certain corporate, institutional, governmental and not-for-profit customers.

Trust and Fiduciary Exception to the Push-Out Provisions: Modification of the Sales to Relationship Compensation Ratio

JPMorgan Chase welcomes a line-of-business alternative to applying the "chiefly compensated" requirement. An account-by-account method of calculation would involve substantial systems modifications and would not be warranted by the applicable statutory language as the sole means of determining compliance with the chiefly compensated requirement.

The Commission requested comment with regard to the proposed "one to nine ratio" in the line-of-business calculation to require banks to compare (i) their "sales compensation" to (ii) their total compensation (rather than their "relationship compensation") from qualifying fiduciary activities. We submit that such a modification would be feasible and desirable. This modification would simplify the calculations to be performed by using a number that can readily be derived from existing financial reporting, e.g., Schedule RC-T to the Report of Condition. Accordingly, making this change to the denominator would obviate the need to overhaul current systems to generate new types of numbers.

Simplicity is desirable in and of itself.

Simplicity in and of itself should be an objective of Rule 721; it is difficult to see how all the intricacies that now attend the "chiefly compensated" test are warranted by the simple, brief statutory language in the GLBA to which it relates. Regulation B should be simplified wherever possible to lighten the regulatory burden on thousands of financial institutions when doing so is consistent with GLBA.

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[6] Id. at 39,692.

Simplification of the ratio would not vitiate the "chiefly compensated" requirement.

GLBA does not prescribe that the denominator of the applicable ratio should be a number other than total compensation. Moreover, as a practical matter, the proposed change should not make a substantial difference. We believe that the quantitative information the Commission requested in this regard would, in our case, appear to support this conclusion. Our general sense is that for certain lines of business for the calendar year 2003, the differences in the two ratios for the lines-of-business that would come within the trust and fiduciary exception would have been less than 1%, because sales compensation represented a small portion of total compensation and because compensation that was neither sales nor relationship compensation was insignificant.

Be advised, however, that we are only able to estimate the difference between the ratio based on "relationship compensation" and the ratio based on "total compensation." It is not possible to obtain precise numbers given (1) the judgments involved in arriving at estimates, which involve interpretational difficulties in classifying various compensation items, and (2) the need to perform many calculations manually, in the absence of systems to implement the currently proposed ratio. We anticipate that there may be substantial expense involved in building the systems which will ensure the precision required by the final rules.

The Commission also requested comment on what compensation items would be included in total compensation that are not included in sales compensation or relationship compensation. Such items include tax preparation fees, fees for handling judicial accountings, and overdraft fees.

The permissible numerator of the ratio should be larger.

The proposed account-by-account exemption contemplates that relationship compensation merely exceed sales compensation. The proposed line-of-business ratio would require a substantially higher proportion of relationship compensation to sales compensation, i.e., relationship compensation would be required to be at least nine times sales compensation. It is not clear why the much more stringent test is warranted in the line-of-business exemption. A more stringent test is not needed to assure that true brokerage in not conducted in the trust and fiduciary areas; true brokerage, if it really existed, would be readily apparent because a brokerage business cannot profitably exist without advertising, solicitation and management. These activities cannot be concealed.

To satisfy the "chiefly compensated" requirement, the numerator of the applicable ratio can easily be substantially larger; the basic constraint should be that the numerator be less than 50 percent of the denominator in the sales-to-total compensation ratio. Doing so would substantially reduce the administrative burden for many banks by permitting them to make assumptions about certain classes of its data rather than going through the expense of precisely classifying such data. For example, a bank may wish to assume that revenue from a particular line of business is all sales compensation (even if this were not the case) rather than performing what could be a complicated breakdown of sales, relationship, and other compensation. Clearly a bank would only do this if it still satisfied the chiefly compensated test despite making such an

unfavorable assumption. While we believe not exceeding a one to two ratio would satisfy the statutory test, we recognize the Commission may not be willing to adopt such a proposal. Any relief regarding the ratio would mitigate the administrative burden.

Cost Savings

It is difficult, if not impossible, to estimate the cost savings that the requested modification would generate. Preliminary indications, however, suggest that savings might be on the order of several millions of dollars for JPMorgan Chase.

Money Market Mutual Fund Investment Products

JPMorgan Chase provides numerous programs that enable its customers to have idle cash invested in money market mutual funds in order to generate a return on that cash. A significant number of JPMorgan Chase's customers with demand deposit accounts or custody accounts use one of these programs. In most instances, these investment products enable our customers to significantly enhance their return on working capital; in some cases, the amount of such assets is significant. It is therefore critical to JPMorgan Chase that we are able to continue to offer our customers a full range of money market mutual fund investment products.

Sweep Account Exception

Given the importance of money market sweep programs to our customers, we are disappointed that the Commission has elected to retain the basic parameters of the definition of "no-load" in Rule 740(c)(1) that had been contained in the Interim Final Rules. In an effort to best serve our customers, JPMorgan Chase offers a wide range of money market mutual funds as vehicles for sweep programs. Many of those funds meet the Commission's narrow definition of "no-load" but, for a variety of reasons, some do not. This latter group of funds is therefore excluded from the terms of the sweep account exception provided in Section 3(a)(4)(B)(v) of the Exchange Act. We believe that the exclusion of these funds is too restrictive and reduces the effectiveness of the sweep account exception.

We strongly believe that the legislative history and language of GLBA supports a definition of "no-load" money market mutual fund that is less restrictive than the Commission's proposed definition and more consistent with the needs of bank customers and banking industry practice. We believe that the appropriate definition of "no load" money market funds are money market funds with no front end "load" or fee and no back end "load" or fee, *i.e.* there is no "load" or fee paid by the investor. This definition is, we believe, the common understanding of a no load fund by mutual fund investors.

A more reasonable definition of "no-load" would allow our customers to continue to select from the full array of money market mutual funds in determining which products are most responsive to their financial needs. The Commission's proposed definition narrows customers' choice on the basis of a rather arbitrarily selected set of fees (chosen originally to classify advertising, not to make investment decisions) and ignores the complex arrangements between funds and their distributors and all of the other factors that can be even more relevant to a

customer in choosing a fund, such as the financial soundness of the fund and its management, the performance of the fund, the fund's unique portfolio7 and the services provided by the fund manager. The Commission's restrictive definition of "no-load" would prevent us from best serving our customers' investment needs.

We are pleased, however, that the Commission has recognized the value to customers of money market mutual funds that do not meet the proposed narrow definition of "no-load" and has provided a means for certain customers to access such other funds via the new "General Exemption" set forth in Rule 776 ("Rule 776") of proposed Regulation B. JPMorgan Chase views Rule 776 as an important instrument in assisting certain customers with meeting their investment goals. Although Rule 776 provides an important exemption for certain customers' investments, we do not believe the rule is a sufficient substitute for a more flexible definition of "no load" that would enable customers to use money market mutual funds to satisfy a broader range of their financial and cash management needs.

Rule 776

We have the following comments on Proposed Rule 776 in response to the Commission's inquiries regarding the scope of the exemption:
[W]e request comment generally on the exemption contained in proposed Exchange Act Rule 776…. Commenters that believe the proposed exemption should be expanded should also explain why any proposed expansion of the proposed exemption would be consistent with the protection of investors.8

We believe that the exemption is too narrow as currently proposed.

As noted, JPMorgan Chase offers customers the opportunity to select many money market mutual funds to give our customers a wide range of investment options. Leaving client cash assets in non-interest bearing accounts effectively deprives those clients of the benefit of accrued interest on those cash assets. The exclusion of classes of customers from investing in certain funds would result in those customers being placed at a disadvantage to their competitors.

For example, many of our business customers, especially our "middle markets" customers, do not meet a $25 million asset test. Most of these customers are sophisticated investors with between $5 million and $25 million in assets. They are clearly able to understand fee structure disclosure documents and do not require a bank to act in narrowly prescribed roles (e.g., trustee, escrow agent) to effect transactions on their behalf. Under the proposal, however, unless we were to effect transactions using only the limited range of functions contemplated by Rule 776(a)(1)(ii) or (iii), these customers would be precluded from choosing an investment strategy that involved any money market fund other than those meeting the narrow "no-load" definition.

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7 The Commission's proposed narrow definition of "no load", for example, makes it impossible for customers with global cash management needs to choose a non-US fund as a sweep vehicle even though the fund may be listed on a foreign exchange and fully regulated outside the US.

8 Regulation B: Exchange Act Release No. 49879, 69 Fed. Reg. 39,682, 39,718 (June 30, 2004) (to be codified at 17 C.F.R. pts. 240, 242).

We support the Commission's goal of protecting unsophisticated investors from paying fees that they do not understand. The Commission has elected to limit the General Exemption to the following circumstances: (i) the transacting bank effects transactions in a trustee or fiduciary capacity within the scope of Exchange Act Section 3(a)(4)(D); (ii) the transacting bank acts as an escrow, collateral, depository or paying agent; or (iii) the depositor in question either meets the definition of qualified investor ("Qualified Investor"), as defined in Exchange Act Section 3(a)(54)(A), or is a person who directs the purchase of securities from any cash flows that relate to an asset-backed security with a minimum original asset amount of $25,000,000 ("Asset-Backed Purchaser").

We understand the Commission believes that these limitations are prudent in order to protect unsophisticated members of the public, particularly retail investors, from investing in money market funds that carry sales loads without an understanding of such funds' fee structures or the benefit of a formal trustee or agent relationship with the entity effecting their transactions. JPMorgan Chase agrees that customers who are Qualified Investors or Asset-Backed Purchasers have demonstrated a level of investment sophistication sufficient to direct their money market mutual fund investments without reliance on the protections provided by the bank agency functions listed in Rule 776(a)(1)(ii) and (iii). We also agree that customers who have not met the regulatory standards for investment sophistication should be afforded the protections of such formal agency functions in addition to the disclosures required by Rule 776(a)(2)(ii)(B). However, we believe that these conditions do not adequately balance the cash management flexibility required by banks to equitably respond to their sophisticated clients' needs with the Commission's desire to protect unsophisticated investors. Rather, JPMorgan Chase believes that certain mid-size commercial depositors with more than $5 million in total assets would be able to appreciate their investment risks without reliance on an agent acting pursuant to the limitations inherent in the formal trustee and agent capacities listed in Rule 776(a)(1)(ii) and (iii).

JPMorgan Chase believes that the General Exemption's current configuration could actually harm commercial depositors who have met the regulatory requirements for investment sophistication, but not those for Qualified Investors. As proposed, the General Exemption prohibits such commercial depositors from enjoying the benefits of both investing in the money market funds of their choosing and selecting the banking relationship appropriate to effect the transactions. Requiring these commercial depositors to rely on certain bank functions in order to obtain the money market fund investments of their choosing, may effectively foreclose desired areas of investment to these sophisticated commercial depositors. They could incur significant opportunity costs that would not be borne by their larger competitors. We are concerned that sophisticated commercial depositors, thus prohibited from investing in the money market funds of their choosing, would be forced to engage in an unwanted banking relationship or let their cash assets remain in non-interest bearing accounts.

Addition of Accredited Investor Standard

We believe that the General Exemption would better serve sophisticated customers by including among the scope of Rule 776(a)(1) the class of sophisticated commercial depositors contemplated by the definition of accredited investor ("Accredited Investor") in Rule 501(a) of

Regulation D of the Securities Act of 1933, as amended ("1933 Act"). Regulation D permits the offer and sale of securities without registration under the 1933 Act, without the provision of any specific disclosure of information, and without reliance on an entity acting in a manner listed in Rule 776(a)(1)(ii) or (iii). The exemptions, therefore, are provided for investors who are deemed to have sufficient financial sophistication and experience to seek out the information they need to make investment decisions without relying on disclosure mandated by the Commission or the 1933 Act itself. A similar rationale should apply to investors seeking to purchase money market mutual funds through their banking relationships.

Presumably, in adopting the definition of Accredited Investor, the Commission concluded that a corporation, partnership or company with $5 million or more in total assets should be credited with the requisite investment sophistication to allow the investor to purchase securities without the benefit of a prospectus or specific disclosures. Thus, for example, such Accredited Investors are allowed to invest at their peril in, among other things, unregistered equity securities. Clearly unregistered equity securities pose greater risks than do shares of a "load" money market fund. Likewise, it is generally assumed that ascertaining the degree of investment risk for unregistered equity securities is significantly more difficult than appreciating the amount and structure of "load" money market fund fees. The exclusive reliance on the Qualified Investor and Asset-Backed Purchaser standards in Rule 776(a)(1)(i) could thus lead to the odd circumstance of prohibiting a commercial depositor, who is an Accredited Investor, from investing in certain money market funds due to a perceived lack of sophistication, while considering the same commercial depositor sufficiently savvy to purchase the equity securities of a high risk company without the benefit of a prospectus or other specific disclosures. We believe this is an absurd result.

In order to help prevent this unintended disparity, JPMorgan Chase believes that the Commission should augment the General Exemption to include the Accredited Investor class of customers in new subsection (a)(1)(iv) of Rule 776. Thus, consistent with the sophistication ascribed to them by the 1933 Act, depositors who are Accredited Investors would be allowed to invest in money market mutual funds unencumbered by any of the special relationships with the transacting bank required by Rule 776(a)(1)(ii) and (iii). We believe that this would allow mid-size, sophisticated commercial depositors the opportunity to equitably access the full range of cash management tools enjoyed by their larger competitors.

"Financial Product or Service Not Involving Securities"

In order for a bank to be exempt from the definition of "broker" for transactions in money market funds effected on behalf of a Qualified Investor, Rule 776(a)(1)(i) requires that the Qualified Investor in question has already "obtained from the bank a financial product or service not involving securities." We request that the Commission clarify that custody services do fall within the quoted language. Such clarification would be particularly helpful to banks when structuring their money market mutual fund investment programs.

Custody services are inextricably tied to a bank's responsibilities concerning certain securities. Custody services, however, have historically been considered a typical feature of the range of services offered by commercial banks. We understand that the Commission may have added the requirement that Qualified Investors have "obtained from the bank a financial product or service not involving securities" in the General Exemption out of concern that Qualified Investors would access a bank's cash management services simply to invest in money market funds. By directly accessing a bank's services that involve securities, Qualified Investors could completely avoid the broker-dealer regulatory structure for the investment of securities. We are aware of the Commission's belief that accepting orders to purchase or sell securities is a core broker-dealer function. JPMorgan Chase believes, however, that the traditional provision of custody services would not give rise to the danger that Qualified Investors would use the General Exemption to avoid a broker-dealer relationship. Rather, we believe that securities transactions effected on behalf of these customers would simply be an accommodative supplement to the customers' overall securities investment activities.

Residual cash left in customer accounts is a necessary byproduct of custody services. Banks have traditionally provided such customers with the additional efficiency enhancing service of programmatically investing their residual cash into money market mutual funds. Thus, custody service customers are afforded the benefit of accrued interest on the residual cash while defraying the operational costs that customers would incur if they were to make daily investment decisions. As a result, customers are able to maintain full investment in the money market mutual funds of their choosing. However, if custody services would not be considered a "financial product or service not involving securities" for purposes of Rule 776, customers would have to rely on another provision of the proposed General Exemption. But as proposed, the General Exemption would exclude our "middle market" custody service customers from the benefit of seamless investment of their custody-related residual cash assets. As a result, such customers would be either forced to incur the operational costs of directing the transfer and investment of their residual cash on a daily basis, or forego accrued interest on this important portion of their assets. We are concerned that such exclusions would needlessly place otherwise sophisticated investors at an investment disadvantage with their larger competitors.

Finally, allowing custody service customers to invest in money market funds is consistent with proposed Regulation B's concern that banks continue to provide limited securities transaction services as part of their traditional customer services. Accordingly, for purposes of Rule 776(a)(1)(i), JPMorgan Chase urges the Commission to clarify that the phrase "financial product or service not involving securities" includes custody services traditionally provided by banks.

Employee Benefits Plans

Definition of Employee Benefit Plans (Proposed Rule 770(a))

JPMorgan Chase believes that the definition of employee benefit plans in Proposed Rule 770 is too restrictive. Rule 770 is drafted solely with an eye towards participant-directed defined contribution plans and applies only "to the extent" that a trust or custodial employee benefit plan is invested in mutual funds or through a participant-directed brokerage window. Many types of traditional employee benefit plans are not participant-directed. These plans generally have a

single commingled investment fund. The trustee may have investment discretion over some or all of the trust assets, may be directed by the plan sponsor with respect to some or all of the trust assets, or may be directed by one or more investment managers appointed by the plan sponsor, which are generally registered investment advisors.

With respect to these plans, as well as plans not covered by Rule 770, banks would have to rely on the trust and fiduciary or custody exemptions. Using the general trust and fiduciary exception will entail complying with the chiefly compensated test. However, because all types of employee benefit plans are generally handled within a single line of business, it appears that Proposed Rule 242.721(c) would require a bank that used the chiefly compensated line of business test for its employee benefit plan business to include compensation received from plans subject to Rule 770 in its line of business calculations. The effect of including such compensation may preclude a bank from being able to meet the chiefly compensated test as applied to this line of business. Thus, to the extent that a bank must comply with the chiefly compensated test for accounts not subject to Rule 770, it might be able to do so only if it applied the chiefly compensated test on an account-by-account basis to those plans that are not already excepted under Rule 770. This may force a bank to choose between performing the chiefly compensated test on an account by account basis or foregoing the benefits of Rule 770 for those accounts covered by Rule 770 in order to perform the chiefly compensated test on a line of business basis. For the reasons noted above, the account-by-account approach would be highly undesirable, if not impracticable. The Commission should clarify that compensation from plans that are exempt under Rule 770 is not taken into account in applying the line of business chiefly compensated test for the employee benefits plan line of business. Even more confusing, in some instances a portion of the plan may be invested in mutual funds while another portion is actively managed in individual securities, but not through a participant-directed brokerage window. In those cases, it is not clear at all how Rule 770 would apply given its limitation that it applies only "to the extent" the plan is invested in mutual funds or a participant-directed brokerage window.

In other cases one or more individuals may be the trustee of a plan with a bank serving as custodian. This is frequently the case for collectively-bargained plans, also known as Taft-Hartley plans, which are required to have a joint board of trustees comprised of both management and union trustees. In such cases, there is no justification for not permitting the bank as custodian from using the general custody exception. Having said that, however, the issues raised in the discussion of the custody exemption below would also be a concern for these employee benefit custody accounts.

JPMorgan Chase strongly urges the Commission to revise Proposed Rule 770 to expand its scope to encompass government plans under §414 of the Internal Revenue Code ("Code"), as well as other plans which are exempt from the requirements of §401(a) of the Code, such as church plans. In addition, certain employee benefit plans which are subject to ERISA, but are not exempt from tax under §401(a) of the Code, but under Code §501(c), such as VEBAs (voluntary employee benefit associations) and SUB plans (supplemental unemployment benefit plans) should also be covered by Rule 770. Finally, "rabbi trusts" which fund non-qualified or supplemental benefit plans and frequently mirror an employer’s qualified plan, should also be covered.

Fee offset requirement (Proposed Rule 770(a)(1))

Rule 770 would require banks to offset all fees received from a mutual fund against fees charged to the plan. Banks and their affiliates frequently provide services directly to mutual funds, rather than a fund's shareholder. These services include custody of the fund's assets, securities lending of the fund's securities, investment management, fund accounting and transfer (as opposed to sub-transfer) agent. Such arrangements must be approved by the mutual fund's board of trustees.

Rule 770 does not distinguish between fees paid to a bank or its affiliate which are related to specific investors with a relationship to the bank or broker, such as 12b-1, shareholder servicing and certain types of revenue sharing fees on the one hand, and fees that are for services that are provided directly to a mutual fund, as described hereinabove. The latter category of fees are necessary for the functioning of a mutual fund and are completely irrelevant to the determination of whether a bank is acting as a broker. The Commission does not require brokers to return such fees to their clients and it should not impose such a requirement on banks.

JPMorgan Chase strongly urges the Commission to clarify that all fees for services provided directly to a mutual fund are, in all circumstances, excluded from the definition of compensation contained in Rule 770. In addition, the Commission should make clear that, to the extent that fees received by a bank from a mutual fund would not be considered sales compensation under Proposed Rule §242.724(i)(6), then a bank should not be required to offset such fees against fees charged by the bank to the plan.

Interpretations by the Department of Labor ("DOL")

JPMorgan Chase is concerned that the Proposed Rule overlays additional requirements already addressed by existing DOL interpretations of ERISA. The requirement of Rule 770 that a bank offset or credit any compensation that it receives from a fund complex against fees and expenses that the bank charges the plan is not generally required of participant-directed defined contribution plans under ERISA, as interpreted by the DOL, and is inconsistent with current practice to that extent.

The Frost Letter, DOL Advisory Opinion 97-15A (the "Frost Letter"), and the Aetna Letter, DOL Advisory Opinion 97-16A (the "Aetna Letter"), represent two ends of the spectrum in terms of the services provided by institutional trustees and have served as a road map for institutional trustees as to the circumstances under which 12b-1 and similar fees may be received by plan service providers with respect to mutual fund investments by employee benefit trusts. Subsequent guidance issued by the DOL, including an information letter dated 8/20/1997 to Judith McCormick of the American Bankers Association ("McCormick Letter") and DOL Advisory Opinion 2003-07A, issued to ABN-AMRO, have further clarified the DOL's position that the Aetna Letter is available to banks serving as directed trustee, including situations where mutual funds advised by bank affiliates are available investment options.

With respect to employee benefit plans for which a bank trustee or its affiliate has discretion over plan investments ("Investment Fiduciary"), the Frost Letter requires that 12b-1 fees received by the Investment Fiduciary be used to offset fees charged by the Investment Fiduciary to the plan and any excess 12b-1 fees deposited to the plan. Frequently in such situations, no 12b-1 fees are received with respect to such plans in order to avoid the need for a dollar for dollar offset.

Since the issuance of the Aetna, Frost and McCormick Letters, institutional trustees have carefully designed their participant-directed plan products to come within the factual setting of the Aetna and McCormick Letters, rather than the Frost Letter, so as to avoid the requirement to use 12b-1 fees for the benefit of the plan, as witnessed by Advisory Opinion 2003-07A. This was due in part to the fact that the requirement of a dollar-for-dollar offset under the Frost Letter was technologically difficult in any setting. The Commission's belief that plan trustees generally offset or otherwise use 12b-1 and similar fees to benefit the plan is contrary to the general practice of banks acting as directed trustees.

The DOL is the primary regulator of fiduciary responsibility and prohibited transactions under ERISA, and makes that responsibility one of its highest priorities. We recommend that the Commission refrain from restating the Commission's understanding of the DOL's interpretation of the rules regarding fiduciary responsibility and prohibited transactions. Such a restatement could create an additional overlay of requirements for banks acting as plan trustees. Instead, JPMorgan Chase strongly urges the Commission to defer to the DOL on such matters. This could be done by providing that banks providing services to employee benefit plans subject to ERISA or to which the IRS has ceded authority to the DOL (which would include prohibited transactions related to IRAs) would not be subject to broker regulation to the extent that the bank acts in accordance with ERISA, as interpreted by the DOL. This approach would incorporate the requirements of the Aetna and Frost letters, as well as future guidance the DOL may issue. In addition, this proposal would subject trust and custodial IRAs to the same rules as employee benefit plans for which a bank serves as trustee or custodian.

General Custody Exemption: Addition of Accredited Investors and Custodial IRA Accounts

JPMorgan has the following comments on Proposed Rule 760 in response to the Commission's request for comment on "limiting this exemption to "qualified investors" on a going-forward basis."

Order-taking is a traditional and customary function performed in conjunction with custodial activities. We firmly believe that order-taking on behalf of all custody customers is encompassed by the exception from the definition of "broker" contained in Section 3(a)(4)(b)(viii) of the Exchange Act of 1934. This view is supported by the legislative history and the language of GLBA.

We are pleased that the Commission has provided an exemption despite its belief that accepting orders to purchase or sell securities is not permitted under the safekeeping and custody exception. JPMorgan is concerned, however, that the exemption contains several unnecessary restrictions which severely limit its utility. We are particularly troubled by the fact that the exemption is limited to Qualified Investors and to preexisting customers as of July 30, 2004.

Addition of Accredited Investor Standard

If the Commission will not extend the exemption to all custody customers, Proposed Rule 760(a) should be amended to extend the scope of the order-taking exemption to Accredited Investors. For the reasons previously enumerated with respect to Rule 776, we believe that Accredited Investors have the requisite financial sophistication and experience to provide direction to their bank custodians regarding the purchase and sale of securities. The Commission has clearly determined that Accredited Investors do not "require the comprehensive protection of the federal securities laws." Consequently, Accredited Investors should be afforded the same convenience that Qualified Investors will receive under the proposed rule and should not be required to incur the unnecessary expense of opening a separate brokerage account for the purpose of placing orders for the purchase and sale of securities.

Addition of Custodial IRA Accounts

Banks provided custodial IRA services, including order-taking, long before brokerage firms entered this business. Indeed, under §408(a)(2) of the Internal Revenue Code of 1986, as amended, *only* banks are able to serve as IRA trustees and custodians without specific approval of the Treasury Secretary: "The trustee is a bank (as defined in Subsection (n)) or such other person who demonstrates to the satisfaction of the Secretary that the manner in which such other person will administer the trust will be consistent with the requirements of this section." Further, Subsection 408(h) provides "For purposes of this section, a custodial account shall be treated as a trust if the assets of such account are held by a bank (as defined in subsection (n)) or another person who demonstrates, to the satisfaction of the Secretary, that the manner in which he will administer the account will be consistent with the requirements of this section, and if the custodial account would, except for the fact that it is not a trust, constitute an individual retirement account described in subsection (a) . For purposes of this title, in the case of a custodial account treated as a trust by reason of the preceding sentence, the custodian of such account shall be treated as the trustee thereof." In the 30 years since IRAs were first authorized under the Internal Revenue Code, banks have serviced IRA custodial accounts, including order-taking, without harm to custodial account holders.

The IRS model forms for trust and custody IRAs, 5305 and 5305-A, respectively, make no distinction between the duties of an IRA trustee and an IRA custodian. In fact, both forms are completely silent as to the duties of the trustee or custodian other than with respect to information filing requirements. Further, the IRS trust and custody forms are word-for-word identical, except that the trust document refers to "trustee" and "grantor" and the custody document refers to "custodian" and "depositor". We appreciate that the Commission has given up its attempt to define what constitutes a "trust or fiduciary" relationship in the Proposed Regulation. Nonetheless the SEC's position that a bank IRA trustee may take orders from the account holder under the trust and fiduciary exception but a bank IRA custodian may not under the custody exception has no basis in the legal documentation that establishes these accounts and elevates form over substance.

If the Commission persists in its position that bank IRA custodians cannot accept orders for custodial IRAs, but that such orders must be placed with a broker, the ultimate effect of that position will be to eliminate bank custodial IRAs over time. Although some IRA account holders choose to maintain a custodial IRA with a bank as well as having a broker for that account, those IRA account holders who do not will not understand why they will need to have both a brokerage account as well as their custodial IRA account, and can be expected to move their custodial IRA to their broker, rather than incur the expense and inconvenience of maintaining two separate accounts. Clearly, that could not have been the intent of Congress when it specifically favored banks as IRA custodians and then enacted a specific exception for bank custodial IRAs.

Rule 3040

Regulation B presents operational and compliance burdens that will cause significant disruption and expense to the routine business of banking. One of the few options available to banks to address the demands of Regulation B is to register large numbers of employees through a broker-dealer (assuming that a banking organization can afford such an expense). However, this alternative is complicated by a different set of uncertainties and burdens.

In the release accompanying the Interim Final Rules, the Commission noted that dual employees who are registered through a broker-dealer must comply with the requirements of NASD Rule 3040.[9] NASD Rule 3040 imposes significant record keeping and supervisory responsibilities on the broker-dealer in order to prevent a registered representative from engaging in unsupervised, unregulated activities. There is considerable room for interpretation about how NASD Rule 3040 should apply in the banking context, where the registered representatives/dual employees are already subject to a different set of carefully constructed regulations and oversight in their banking activities.

The NASD has indicated that it would issue clarifying guidance regarding Rule 3040. However, no guidance has been issued despite several years of uncertainty. It is unpalatable to plan to register a large number of employees if the burdens of NASD Rule 3040 ultimately prove to be as daunting as the demands of proposed Regulation B. JPMorgan Chase therefore urges the Commission to work with the NASD and the banking industry to develop clarification of Rule 3040 that eases rather than exacerbates the burdens already facing the banking industry.

[9] 66 Fed. Reg. 27,793 (2001).

Implementation Period

JPMorgan Chase appreciates the efforts of the Commission to work with the banking industry to allow adequate time to implement proposed Regulation B. We note the tremendous burdens and technological efforts that will be necessary to comply with the various aspects of this new regulation. We respectfully recommend that additional time beyond January 1, 2006 will be necessary to implement these proposals.

We would be pleased to discuss any of the matters raised in this letter with the Commission or its staff.

Very truly yours,

Ronald C. Mayer