



September 1, 2004

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

Re: Proposed Regulation B; File Number S7-26-04

Dear Mr. Katz:

The Bank Insurance and Securities Association (“BISA”) welcomes the opportunity to comment on the Securities and Exchange Commission’s (“SEC”) Proposed Regulation B,¹ on behalf of its bank-affiliated broker-dealer members.²

BISA appreciates the SEC’s hard work in providing financial institutions with guidance on the application of various broker exceptions contained in Title II of the Gramm-Leach-Bliley Act (“GLBA”). BISA also thanks the SEC staff for devoting significant amounts of time and other resources to meeting with BISA and other trade associations in order to promote a dialogue between the SEC and the financial services industry. That dialogue, which we hope will continue, has proven to be a valuable tool in fostering communications between the SEC and the industry.

I. Summary of BISA’s Position

As a threshold matter, BISA recognizes that the SEC’s proposals to implement the bank exceptions from the definition of “broker” found in Section 3(a)(4)(B) of the Securities

¹ See Securities Exchange Act Release No. 49879 (June 17, 2004) (“Proposing Release”).

² BISA is the largest association representing financial institutions in selling securities and insurance in the bank distribution channel. It was formed through the merger of the Bank Securities Association (“BSA”) and the Financial Institutions Insurance Association (“FIIA”). Its 450 institutional members are a cross section of banks, thrifts, credit unions and the various businesses that support their products and services. BISA has members in all 50 states, and its publications are distributed to 25,000 institutions and persons throughout the United States and in seven countries.

Exchange Act of 1934 (“Exchange Act”) represent an attempt to apply its investor protection mandate to legislation that sought largely to codify existing banking practices. BISA is concerned, however, that in its proposed application of Exchange Act Section 3(a)(4)(B)(i) (the “Networking Exception”), the SEC is proposing to limit existing bank compensation practices,³ in a manner that goes beyond prior SEC staff no-action letters⁴ and self-regulatory organization rules,⁵ without furthering the SEC’s investor protection goals. BISA therefore believes the SEC should reconsider its proposed application of the Networking Exception to bank compensation practices as discussed below.

II. Application of Networking Exception to Bank Bonus Programs

BISA is concerned that in attempting to define the “one-time” limitation on the payment of referral fees, the SEC may have unintentionally restricted the ability of banks to pay employee bonuses generally. BISA does not believe GLBA intended the SEC to prohibit a bank’s *bona fide* bonus or similar programs that include income or revenue from all activities, a component of which is securities operations. We therefore request that the SEC delay implementation of this aspect of proposed Regulation B until it clarifies its position on bank employee bonuses. Since this is a matter critical to bank compensation programs, BISA also requests that any such clarification provide adequate opportunity for industry comment.

The Networking Exception prohibits “incentive compensation” to unregistered bank employees “for any brokerage transaction” unless such employees are duly registered associated persons of a broker-dealer.⁶ The Proposing Release, however, appears more restrictive than the statutory exception, because it may be read to prohibit a bank from including profits earned from

³ The framework for banking practices under networking arrangements is proscribed primarily by the Interagency Statement on Retail Sales of Nondeposit Investment Products. See Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, and Office of Thrift Supervision, *Interagency Statement on Retail Sales of Nondeposit Investment Products* (February 15, 1994) (“Interagency Statement”).

⁴ See e.g., *Chubb Securities Corp.* (November 24, 1993) (“*Chubb*”). See also Securities Exchange Act Release No. 49879 (June 17, 2004) at fn. 37, “[t]he statutory conditions under which banks may rely on the networking exception stem from a line of no-action letters in which the Commission staff indicated enforcement action would not be recommended against thrifts that entered into highly circumscribed networking arrangements” (citing H.R. Rep. No. 106-74, pt. 3, at 163 (1999)). The letters provided thrifts with a means to compete with commercial banks in making securities brokerage services available to their customers. *Id.*

⁵ See e.g., NASD Rule 2350, which governs broker-dealer activities on the premises of a financial institution. The SEC approved Rule 2350 in Securities Exchange Act Release No. 34294 (November 4, 1997).

⁶ See Exchange Act Section 3(a)(4)(B)(i)(VI).

brokerage activities in the computation of unregistered employee bonuses, unless the computation is conducted at the bank or bank holding company level.⁷

BISA believes that in applying restrictions on referral fees to bank bonus programs, the SEC may have inadvertently linked two, distinct means of bank employee compensation: a referral fee program, which provides specified employees with a nominal one-time cash fee of a fixed dollar amount as permitted under the Networking Exception; and a bonus program, which by contrast may compensate employees within a branch, department or line of business of a bank based on all products and services at the relevant unit. A bank bonus program that bases bonuses on a system of measurement which takes into account all products and services at the relevant branch, department or line of business should not be prohibited from including securities among the products and services credited to that bank unit.

BISA is also concerned that if read narrowly, the Proposing Release may prohibit an unregistered bank employee who received referral fees from receiving a bonus that takes into account the profitability of a branch, department or line of business of a bank whose revenues include securities activities.⁸ Read broadly, the Proposing Release may be viewed as stating that no unregistered bank employee may receive a bonus that takes into account all of the different products and services, including securities, that are credited at the branch, department or other level of the bank. Such a restriction would be inconsistent with many current bank compensation policies and would go beyond established precedent, while providing no obvious investor protections. We further note that although banks have been including profits from brokerage activities in their bonus programs for many years, bank regulators have not objected to this practice and BISA is unaware of any problems or abuses resulting from the administration of such programs.

BISA requests a clarification that banks may take into account the profitability of a branch, department or line of business of the bank from all activities, including securities, in determining employee bonuses, provided that they do not use the bonuses as a means to circumvent the federal securities laws by paying unregistered employees transaction-related compensation. A more restrictive interpretation of the SEC's guidance on bonuses in the Proposing Release would

⁷ BISA notes in particular, the SEC's statement that "a bank could not rely on the networking exception and use bonuses as a means of indirectly paying unregistered employees brokerage-related compensation based on the performance of a branch, department or line of business of a bank." Proposing Release at fn. 62.

⁸ In the Proposing Release, the SEC stated that "[A]ny bonus or other compensation that is payable based in part, directly or indirectly, on a referral fee for which the employee has already received a referral fee, would violate the exception's requirement that brokerage-related incentive compensation paid to unregistered employees under the exception be limited to 'one-time' referral fees." See Proposing Release at part III.2.b.

go beyond the statutory intent, and arguably the statutory authority granted to the SEC under GLBA, and beyond existing practices, without providing additional investor protections.

BISA believes that to the extent the SEC has concerns over the administration of bank employee bonus programs, it should consider delaying resolution of this issue to allow the banking industry and the SEC staff to discuss it further. This would permit the SEC staff to better understand the administration of bonus programs in today's complex financial institutions, and it would be in the best interests of both the SEC and financial institutions.

III. Application of Networking Exception to Non-Cash Referral Fees

BISA appreciates the SEC's decision to allow bank employees to be rewarded in connection with brokerage referrals with non-cash "points" or "units" that may make the employee eligible for a bonus or other award in the future. Many banking organizations currently rely on point systems to reward employees, rather than relying solely on immediate cash compensation. BISA believes, however, that the SEC's proposed requirements for such a point system is unnecessarily narrow, without providing investors with additional protections.

The Proposing Release would require that, to the extent any portion of a referral fee is not paid in cash, it must: (i) be paid in units of value with a readily ascertainable cash equivalent; (ii) have, together with any portion of the fee paid in cash a total cash value that does not exceed the aggregate amount permitted for cash referral fees; and (iii) be paid under an incentive program that covers a broad range of products and that is designed primarily to reward activities unrelated to securities. BISA believes that items (i) and (iii) above make the proposal extremely cumbersome, subject to wide and varied valuation methods, and unworkable in practice, while being more restrictive than the Networking Exception requires. We note also that these items were not included in the SEC's Interim Final Rules implementing GLBA in May 2001.⁹

Item (i) is unworkable because it may be difficult or even impossible to know the specific cash value of points to be earned towards a bonus awarded later.¹⁰ It is also unclear why specific knowledge of the value of a set of points at the time of the referral should matter, provided the amount is nominal. Item (iii) is more restrictive than the Networking Exception requires because the Networking Exception explicitly contemplates referral fees as incentive compensation

⁹ In the Interim Final Rules the SEC required only that a point system be part of an overall system that includes products other than securities and lines of business other than brokerage, and that the securities related points have a nominal value no greater than the points received for non-securities products or services. *See* Securities Exchange Act Release No. 44291 (May 11, 2001).

¹⁰ For example, if at the time of a referral the recipient of an award is unknown and the value of the award will be determined based on branch or even overall bank earnings during a stated period, it may not be possible to ascertain the cash value of the points.

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relating *solely* to securities activities. Item (iii), by contrast, provides an exception solely for programs designed primarily to reward activities unrelated to securities. We therefore request that the SEC amend its proposal to provide more flexibility to banks regarding their use of non-cash compensation to reward unregistered employees that is more in line with the Networking Exception.

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BISA appreciates the SEC's consideration of its comments on Proposed Regulation B. We also look forward to a continuing dialogue with the SEC staff on the important matters raised by GLBA, including matters not raised in the Proposing Release.¹¹ If the SEC has any questions relating to BISA's comments or would otherwise like to discuss them further, please contact either John F. Hartigan, General Counsel of BISA, at 213.612.2630, Kathleen W. Collins, BISA's Washington Counsel, at 202.739.5642 or Jack P. Drogin at 202.739.5380.

Sincerely,

Richard D. Starr
Director – Government Relations

¹¹ For example, BISA is interested in discussing the restrictions on advertising relating to networking arrangements found in the Networking Exception. We also are interested in discussing the application of NASD Rule 3040 to dual bank/broker-dealer employees.