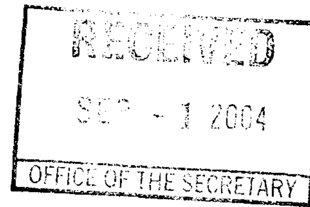
National City

National City Corporation
National City Center
P.O. Box 5756
Cleveland, OH 44101-0756
216-222-3218

James R. Bell III
Executive Vice President



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August 31, 2004

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

Re: File No. S7-26-04; Comments to Proposed Regulation B of the Securities Exchange Act of 1934 and Release No. 34-49879, 69 Fed. Reg. 39682 ("Proposed Regulation B")

Dear Mr. Katz:

National City Corporation, a one hundred thirty-four billion dollar ($134 Billion) financial holding company headquartered in Cleveland, Ohio, with subsidiary banking institutions and a full service broker-dealer serving the seven (7) state area of Ohio, Pennsylvania, Indiana, Kentucky, Michigan, Illinois, and Missouri ("National City"), wishes to submit its comments to Proposed Regulation B.

On July 16, 2001, National City submitted a comment letter regarding the SEC's Interim Final Rules for Banks, Savings Associations and Savings Banks Under Sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934 ("Interim Final Rules"). In that comment letter (the "Prior Comment Letter"), National City expressed its view that the Interim Final Rules created a burdensome regulatory environment and were overly complex, costly to implement, unworkable, and inconsistent with centuries-old fiduciary principles.

Unfortunately, Proposed Regulation B contains the same fundamental flaws as the Interim Final Rules. The staff of the Securities and Exchange Commission ("SEC") continues to misinterpret both the language and the legislative history of Title II of the Gramm-Leach-Bliley Act ("GLB"). In GLB, Congress enacted certain statutory exceptions to the definitions of "broker" and "dealer" which would allow banks to continue to engage in certain activities in which they have traditionally engaged. It was Congress' intent that these activities would not be subject to SEC regulation and would be conducted without unnecessary burdens.

Instead, the approach that was taken in the Interim Final Rules and continues over into Proposed Regulation B is just the opposite of that contemplated by GLB. The SEC has proposed exemptive rules that purport to allow banks to engage in traditional fiduciary activities but only if they meet complex, burdensome, costly, and unreasonable conditions. None of this complexity is necessary. The statute is not complicated. Close adherence to GLB should result in much simpler regulations than those that appear in Proposed Regulation B.

It is clear that in drafting Proposed Regulation B, SEC staff has ignored an entire body of fiduciary law. SEC staff has engrafted securities law concepts into regulations that do not permit traditional banking activities to continue, but rather constrain those activities. In addition, it appears that Proposed Regulation B is attempting to inject the SEC into a role of regulating bank fiduciary activities. This use of securities law concepts and SEC regulatory oversight is both inappropriate and contrary to law.

Because Proposed Regulation B is as fundamentally flawed as the Interim Final Rules, SEC staff should rewrite these regulations in a manner that complies with GLB and Congressional intent. SEC staff also needs to pay closer attention to the banking regulators and the rest of the banking industry so that the regulations accurately reflect traditional bank fiduciary activities. If SEC staff is unwilling or unable to draft reasonable regulations that follow the law, preserve banks' historical business practices without undue burdens and unreasonable conditions, and leave out inappropriate securities law references and SEC regulatory oversight, then Congress should transfer responsibility for drafting the regulations to a federal regulator with a staff who has the substantive knowledge and willingness to follow the statute.

While it is tempting to end our comment letter at this point, we feel compelled to make specific comment on certain of the more troubling aspects of Proposed Regulation B. The comments that follow address these more glaring obstacles to the traditional business of banking.

Trust and Fiduciary Activities Exception

1. The SEC continues to regard 12b-1 fees as "sales compensation" for purposes of the "chiefly compensated" requirement. Such a position ignores the fact that banks have historically received these fees in performing traditional administrative or recordkeeping activities for fiduciary accounts. The SEC needs to recognize that banks provide a valuable and economic service to mutual funds when providing shareholder services. If banks did not provide these services, mutual funds would be required to create millions of additional accounts and provide the accounting services that banks otherwise provide for their fiduciary customers. These fees should be treated as a permissible "percentage of assets under management."

2. There are several aspects of the proposed "line-of-business" approach under the "chiefly compensated" requirement which renders it inadequate in its present form as a viable alternative to the account-by-account calculation. The account-by-account calculation as contained in Proposed Regulation B effectively reads the trust and fiduciary activities exemption right out of GLB.

a. Proposed Regulation B measures "chiefly compensated" by comparing "sales compensation" to "relationship compensation." We believe that the one-to-nine ratio of "sales compensation" to "relationship compensation" permitted by the proposed regulations is too low. Instead, "sales compensation" should be measured against all revenues received by a bank in connection with its trust and fiduciary activities and should be permissible as long as "sales compensation" does not exceed 50% of such total compensation. This would greatly simplify a bank's task of complying with the "chiefly compensated" requirement and would avoid the burdensome job of having to monitor "sales compensation," "relationship compensation," and "unrelated compensation."

b. One of the conditions that a bank must meet in order to utilize the line-of-business alternative is that the bank must maintain procedures reasonably designed to ensure that, before opening or establishing an account for which it will act in a trustee or fiduciary capacity, the bank reviews the account to make sure that the bank is likely to receive more relationship compensation than sales compensation with respect to that account.

At many banks, bank salespersons who generate new business and open accounts do not know, at the time the account is opened or established, the extent to which a mutual fund may pay 12b-1 fees. In order to avoid conflicts of interest, firewalls are created so that employees in sales/investment positions are not aware of the specific terms of shareholder servicing fee arrangements with mutual funds. The "back room" employees, who do have this information, are not involved with the account until after it has been established and the contract has been signed. Thus, as a practical matter, it will be difficult, if not impossible, for a bank to know at the outset if a specific account will generate more relationship compensation than sales compensation, particularly if all 12b-1 fees, including those paid for recordkeeping and similar shareholder services, are counted as "sales compensation."

c. For multi-bank financial holding companies and bank holding companies, it is not clear whether Proposed Regulation B requires the line-of-business approach to be applied on a bank-by-bank basis or whether it can be performed across several banks within the holding company organization. When this question was posed to SEC staff in a series of questions submitted by the American Bankers Association, the response was that this issue was more suitable to be addressed on a case-by-case basis through the no-action process. Such a position in fact makes the SEC a primary regulator of banking institutions' trust and fiduciary activities which is unacceptable and contrary to functional regulation as mandated by GLB.

Many, if not most, multi-bank financial/bank holding companies operate within a functional management structure so that, for example, trust/fiduciary business executives serve in their capacities for every bank under the holding company umbrella. As a result, the true trust/fiduciary "line-of business" for these organizations is the functional business group that spans across all of the banks in the organization. To limit the line-of-business alternative to lines of business within a particular bank belies the practical reality of most large bank organization structures. Such a restriction would also cause considerable additional expense for banking institutions who would have to maintain separate tracking systems for each of their banks. To force banks to submit individual no-action letters would create unnecessary paperwork for both the banks and the SEC and would unduly delay the resolution of this issue.

3. Proposed Regulation B provides that the trust and fiduciary activities exception is available to a bank providing investment advice for a fee only if the bank does so in a fiduciary capacity in which the bank owes its advisory customer a duty of loyalty, including an affirmative duty to make full and fair disclosure of all material facts and conflicts of interest.

The SEC is attempting to impose a different standard of fiduciary obligations on banks under a statutory scheme that is not applicable to banks. In the second paragraph of footnote 190 of Proposed Regulation B, the SEC states, "Of course, a fiduciary has a duty to disclose fully all material conflicts of interest. For guidance on the fiduciary disclosure obligations that characterize the status of a bank acting as an investment adviser for a fee, a bank seeking to rely on the exception may look to the disclosure obligations applicable to an investment adviser under the Investment Advisers Act." (emphasis added).

A national bank's fiduciary obligations are governed primarily by Part 9 of the OCC's regulations and, where applicable, by the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). Even when acting as an investment adviser for a fee, a national bank's fiduciary obligations, including conflicts of interest, are adequately covered by, and should continue to be controlled by, Part 9 (and, as applicable, ERISA), and not by the Investment Advisers Act. While registered investment advisers may be able to engage in certain activities that constitute a conflict of interest as long as they properly disclose the conflict, a bank generally may not do so unless the client affirmatively consents. The SEC has agreed not to define the sources for the duty of loyalty, so it makes no sense for it to attempt to define what that duty is, particularly by cross-referencing the securities laws.

4. We urge the SEC to revise its definition of "investment adviser" in proposed Rule 242.724(d) to include those investment management services where a bank provides asset allocation advice to a customer for a fee and monitors the performance of investment managers selected by a customer to determine whether the investment managers are meeting the customer's investment objectives and asset allocation targets. Investment management services provided by banks have grown beyond merely making investment decisions for a customer or making investment decisions with the customer's approval. It appears that the SEC does not perceive this type of service as falling within the trust and fiduciary activities exception. We strongly disagree with this interpretation. Picking stocks may be one form of investment advice but it is not the only form. By interpreting GLB to require a bank to "review, select or recommend specific securities for its customers" in order to qualify as an investment adviser under this exception is outdated, outmoded, and unsupported by GLB.

Safekeeping and Custody Activities Exception

1. Title II of the Gramm-Leach-Bliley Act ("GLB") provides an exception from broker-dealer registration with respect to certain securities-related safekeeping and custody services that banks may perform for their customers. The SEC has taken the position that GLB does not, however, allow banks to accept or take orders directly from customers, with limited exceptions.

a. One exception, the "general custody" exception, allows banks to accept orders to effect securities transactions for any custodial account opened before July 30, 2004, or for accounts opened after July 30, 2004 for "qualified investors" only. The SEC provides no justification for limiting the scope of the exception in this manner. National City continues to oppose any limitation on a bank's ability to take orders while serving in a custodial or safekeeping capacity and urges that the order-taking exception be amended to apply to all custody customers. At the very least, the part of the general custody exception pertaining to accounts opened after July 30, 2004 should be expanded to include additional customers besides "qualified investors," including, but not limited to, not-for-profit organizations, municipalities, insurance companies, school districts, hospitals, park districts, library districts, and registered investment advisers who place orders in managing client accounts (the SEC already regulates investment advisers).

Banks have been accepting orders in a custodial/safekeeping capacity for many years as an accommodation to their clients. Brokers will charge a commission—banks will not. Brokers will take a spread on bond issue transactions--banks will not. Brokers will not generally buy no-load shares whereas bank intermediaries usually buy institutional fund (no-load) shares for custodial clients. In addition, these clients will have to pay a settlement cost to the bank for delivery vs. payment settlements into the bank custody account. Mutual funds cannot be settled delivery vs. payment which will require additional paperwork to transfer the funds from the broker to the custody account and back again for a sale. Auditors of these entities prefer to

review their asset holdings all in one custody account. Requiring these entities to maintain numerous accounts at different fund companies and brokers in order for them to gain access to certain investment products will certainly increase their audit and reconcilement expenses.

Not-for-profit organizations frequently receive shares of stock as a gift and want their bank custodian to be the one to sell those shares of stock. At National City, we estimate that our banks place more than one thousand (1,000) sale trades per year in a custodial/safekeeping capacity for not-for-profits who have received such gifts of stock.

Networking Exception

In its Prior Comment Letter, National City expressed great concern over the SEC's proposed restrictions on payments of referral fees to non-registered bank employees and the restrictions on bonus programs.

1. With respect to the payment of referral fees to individuals, because the restrictions are not limited by their terms to retail referrals, the limitation on the payment of "nominal" referral fees arguably applies to institutional referrals as well. Congress, when enacting GLB, had envisioned the codification through regulation of those provisions contained in the Interagency Statement on Retail Sales of Nondeposit Investment Products which is limited to sales occurring in a retail setting.

2. Proposed Regulation B attempts to define "nominal" by using three (3) alternatives: an employee's base hourly rate of pay, $15 in 1999 dollars, and $25. For ease of administration, only one test, not three, should be utilized. Each of the three (3) alternatives proposed by the SEC is still unduly restrictive. We believe that a flat fee amount is more appropriate and that it should be at least $25, adjusted for inflation.

3. In addition, the bonus program restrictions in Proposed Regulation B still present significant concerns. The SEC proposes to define "nominal one-time fee" to clarify that a referral fee may be paid to a bank employee no more than one time per customer referred by the employee. The SEC states that any bonus plan or other incentive compensation that is payable based in part, directly or indirectly, on a referral for which the employee has already received a referral fee, would violate the "one-time" requirement. Many bank bonus plans contain performance goals and objectives that involve business referred to various areas of the bank and its affiliates, including business referred to an affiliated broker-dealer. The proposed definition of "one-time" casts doubt on the continued validity of these plans. These bonus program restrictions place, in effect, the SEC as the regulator over bank bonus plans. This is yet another example of the SEC injecting itself as the primary regulator over traditional banking activities which is contrary to functional regulation as mandated by GLB.

As we did in the Prior Comment Letter, National City requests the SEC to eliminate the restrictions pertaining to bonus programs altogether and limit the restrictions to cash referral payments to bank employees in a retail branch setting. The adoption of a more stringent position makes no business sense, adds an administrative burden on banks to track and calculate any and all such payments, and has a chilling effect on serving and meeting customer needs.

Sweep Account Exception

1. GLB excepts a bank from the definition of broker to the extent that a bank sweeps deposit funds into a no-load money market mutual fund. In the Interim Final Rules, the SEC defined "no-load" to mean Rule 12b-1 fees of not more than twenty-five (25) basis points. Despite numerous bank industry comments opposing this limitation, the SEC has chosen to retain this NASD interpretation of "no-load," thus prohibiting banks from continuing long-established practices widely thought to be authorized by GLB.

Banks receive 12b-1 fees for performing record-keeping services and shareholder servicing. Banks typically maintain one "omnibus" (pooled) account with a mutual fund company for thousands of its customers. If the restriction on the receipt of 12b-1 fees stays intact, money market mutual funds will have to incur additional fund recordkeeping costs which will ultimately be borne by the fund shareholders.

The Congressional drafters of GLB never envisioned such a restrictive definition of "no-load." The proposal will have a significant impact on banks. The receipt of 12b-1 fees should be irrelevant in the definition of no-load money market mutual funds. Sweep transactions are conducted through automated technology without human intermediaries so that concerns about "investor protection" should be minimal. The SEC's definition of "no-load" will add an extra, totally unnecessary, step into sweep transactions, thus creating significant administrative expenses for banks and inconveniencing bank customers.

Investing Qualified Investors in Money Market Mutual Funds

1. In response to requests from some commenters that the SEC provide banks with more flexibility to offer cash management services to their customers, the SEC has proposed a general exemption that would allow banks, under certain conditions, to buy and sell money market securities for certain customers, such as "qualified investors."

This exemption is much too limited. The exemption should be broadened to apply to the purchase or sale of any no-load mutual fund, not just money market funds. If the mutual fund is no-load and thus involves no sale compensation, why not permit the transaction? Banks need more flexibility in order to accommodate customers with the cash management services that they need. For example, escrow agreements often permit investments in more than just money market funds, such as short-term government funds and other no-load investments.

Employee Benefit Exemption

1. Proposed Rule 770(a)(1) requires a bank that purchases or redeems mutual fund shares for the account of an employee benefit plan to "offset or credit any compensation that it receives from a fund complex related to securities in which plan assets are invested against fees and expenses that the plan owes the bank." The SEC appears to base this requirement on an Advisory Opinion of the Department of Labor (the "DOL") known as the "Frost Letter," rejecting an equally acceptable alternative approach approved by the DOL in another Advisory Opinion—the "Aetna Letter."

In following the Frost Letter approach while rejecting the approach in the Aetna Letter, the SEC states that "banks advised the [SEC] staff that they do a dollar-for-dollar offset, or credit, of the compensation they receive from the funds that they offer to plans against the fees imposed on the plans themselves" and that "no bank has advised the [SEC] staff that it does not apply mutual fund fees for the benefit of the plans."

The SEC is in error in believing that all banks offset Rule 12b-1 fees against expenses charged to employee benefit plans. Rather, most banks do not offset Rule 12b-1 fees in this way for plans in which they serve in a directed capacity. Institutional trustees have been careful to design their participant-directed plan products to follow the factual settings and DOL guidance set forth in the Aetna Letter and a subsequent DOL Advisory Opinion, the ABN-AMRO Letter.

The SEC should not get involved in deciding which of several approaches – each of which has been approved by the DOL – is best. The DOL is the primary regulator of fiduciary responsibility and prohibited transactions under ERISA. The SEC should defer to the DOL's guidance on these matters and revise Proposed Rule 770 guided by that concept. Proposed Rule 770 should state that banks who render services to employee benefit plans subject to ERISA are not considered "brokers" under the Exchange Act to the extent the bank acts in compliance with ERISA, as interpreted by the DOL.

2. The SEC proposes in Proposed Regulation B to exempt bank trustees and non-fiduciary administrators that effect transactions in securities of open-end companies for participants in employee benefit plans. Under this exemption, banks are permitted to offer these plans access to securities and funds beyond those offered in the plan menu. <u>However</u>, in order to do this, Proposed Regulation B states that banks must offer participant-directed brokerage accounts through a registered broker-dealer. Many banks offer these services through a trading desk housed in the bank, not through a registered broker-dealer. By imposing this requirement, SEC staff appears to be under the mistaken belief that "investor protection" is lacking. This is untrue. When a bank is acting as trustee to an employee benefit plan, the bank has a fiduciary duty to properly execute trades. This requirement will have a major financial impact on banks and their customers.

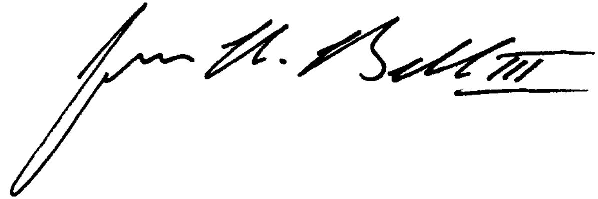
<u>Dual Employees</u>

1. In footnote 289 to the release accompanying the Interim Final Rules, the SEC indicated that it expects the NASD to use NASD Rule 3040 to cause bank-affiliated broker-dealers to become involved in overseeing the bank activities of registered representatives who also provide bank services which, in turn, will cause the NASD to become involved in overseeing such bank activities. <u>This cannot happen.</u> Such a course of action completely contradicts the GLB concept of functional regulation. An amendment to Rule 3040 is needed that would: (a) allow a registered broker-dealer to give a blanket consent to its representatives to act in a dual capacity; (b) provide that bank activities must be supervised <u>only</u> by bank managers; and (c) make clear that banking activities are to be overseen by federal bank regulators as the primary functional regulator.

Conclusion

National City requests that the SEC commissioners direct the SEC staff to start over with a clean slate and write new regulations in a way that reasonably implement the statutory mandate of GLB without imposing SEC jurisdiction and securities law requirements into areas where they do not belong. The legislative history of GLB is clear that Congress expected that the SEC would not disturb traditional bank trust and fiduciary activities, and yet that is exactly what is about to happen under Proposed Regulation B. The SEC needs to draft regulations that are simpler, less burdensome, less detrimental to the public interest, and consistent with the intent and statutory provisions of GLB.

Very truly yours,



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