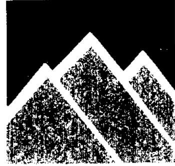
HILLTOP  NATIONAL BANK

PHONE 265-2740 • P.O. BOX 2680 • CASPER, WYOMING 82602

August 27, 2004

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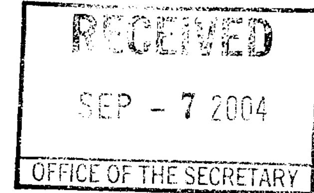


Mr. Jonathan G. Katz, Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

Re: Proposed Regulation B

S7-26-04

Dear Mr. Katz:

It is a pleasure to respond to your Proposed Regulation B on behalf of our community bank as well as on behalf of the other staff members in our department, all of who, including myself, have worked in much larger regional banks. Hilltop National Bank is a community bank with a total asset base of $300+ million and over $375 million in trust assets. We serve clients of Casper and Central Wyoming with six branches and numerous ATM machines, plus we offer Internet banking and Internet access to our trust clients.

Our understanding of the intent of the Gramm-Leach-Bliley Act was to place the trust business on a more level playing field, which it appears to accomplish in some cases; but in all honesty, in reviewing the Proposed Regulation we are struck by what we feel is quite the opposite. No other industry, broker/dealers, insurance companies, mutual fund companies, investment managers, consultants and financial planners, among others, all of which compete with the trust industry, especially in the 401(k) market, have limits imposed by law on their income.

We would like to take each Rule proposed and offer our comments, questions and data when possible. Given the time frame for response and the complexity of the proposal, our understanding may not be as thorough as we would like, but we hope our comments are of value to the Commission. We would also have preferred to provide more hard data, but have made an earnest attempt to comply with the request of the Commission.

Rule 710. Does the Commission plan on limiting the banks' compensation under the networking arrangement? Most current contractual arrangements call for the bank to receive 75% of the revenue generated by the registered broker/dealer representative. Will 12b-1 revenue generated by the registered representative be limited in some manner or will it need to be accounted for by the banks? Would this revenue be subject to the proposed 25 basis points limit and then be included in the $100,000 limit for community banks?

We do not disagree with the definitions you referenced for "nominal" but it is still a relative term. A CEO's $500,000 annual salary may be nominal when compared to a total compensation package of $15 million. The one-time fixed cash fee ($15 in 1999 terms or $25) does not provide much in the way of an incentive for referrals. Our bank with 160 employees has run incentive programs for usually no longer than 90 days. The short period is due in large part to the significant time required by staff to set up, explain, track numbers, answer questions, generate reports, calculate the awards and have them entered into the payroll system – all of which is extremely time consuming. One officer-level person can easily spend a week during the 90 days to oversee the program. To maintain a referral reward program it should provide meaningful incentives to truly be effective. It is questionable that the proposed dollar amounts can accomplish that goal. We do not believe that a more meaningful reward will result in non-registered individuals selling securities. There are too many existing controls in place that will prevent this from occurring. Further, we believe the amount of any incentive should be left up to the institution or at least have the minimum raised to a meaningful percentage.

Rule 721-724. Our Trust Department does not currently receive sales compensation, as we understand how that is defined. Our accounts are charged fees based on a percentage of the assets subject to a minimum annual fee. In very limited circumstances we charge a flat dollar fee to the account regardless of asset size or activity. We also charge a fixed fee for each specific service that we may perform for our Plan Administration Record Keeping Service for Employee Benefit Plans. We do not know the history behind the 1 to 9 ratio but it appears to be potentially out-of-date with the realities of current business practices. Percentages are usually easier to work with, but rounding is a question. Does

11.2% equal 11% and 11.5% equal 12%? We suggest a larger range of 15% might be more acceptable and practicable. The concept of a safe harbor rule has much merit but the ratio of 1 to 7 seems very stringent for those institutions that may have barely missed the 1 to 9 ratio. It would seem to be more practicable that the second year numbers be combined with the first year numbers and an overall percentage calculated. Fee revenue is subject to many factors over which a financial institution has no control. Market value swings, customer additions to their accounts, market conditions that call for more trading, and the loss of a significant account are just a few examples.

Relationship compensation should be expanded to include artwork, jewelry, coins and other collectables, all types of personal items, i.e., vehicles, tools, and management of farm and ranch enterprises (not just the real estate), to name a few items for your consideration.

The Commission's adding of exemptions for existing living, testamentary and charitable trusts may or may not be helpful to financial institutions depending on their book of business. If these types of accounts represented 75% of the total income and the majority of their sales compensation came from the other 25%, it might be impossible for them to meet the 1 to 9 ratio. Also, the Commission should include conservatorships, guardianships and possibly estates in this group.

A question has arisen on the Line-of-Business Exemption. If a financial institution identifies four lines-of-business, applies the test and finds that three of them meet the test, can the institution then combine all four to comply or would the institution need to use the safe harbor test for the failed line-of-business?

Since most community banks and even larger regional banks use a third party software vendor for their accounting and fee collection systems, it is impossible to determine at this time if that information can or will be supplied by vendors to effectively monitor the revenue. Manual calculations or programming software changes would be extremely expensive and time consuming in either case. One additional full-time employee could easily be required in a bank our size to comply, and that expense is not offset by potential increased revenue.

Rule 740. Sweep fees. No direct comment on the proposed Rule. We do believe that common usage in the industry of the term "No-Load Funds" did not exclude 12b-1 fees, shareholder service fees and the like. It is common for customers to think primarily of sales charges in the context of load funds. Further, I am not aware of any financial institution that uses a money market fund that assesses a sales charge. In fact, we venture to guess that there are very few funds that even offer a money market fund with a corresponding sales charge. Funds with 12b-1 features are very common and current Trust Examiners as well as the Department of Labor strictly enforce customer disclosure on acceptance of those fees. We do not believe their usage should be restricted or eliminated but that usage should be fully disclosed and updated with customers on at least an annual basis. The disclosure by the brokerage industry to clients currently pales in comparison to what most banks provide their customers for lending, deposits and trust services.

Rule 750. Affiliate Transactions Exception. No comment on this proposed Rule.

Rule 760. We would strongly urge that the Commission reconsider its position that the acceptance of orders from clients to purchase or sell securities is not a normal bank function in providing custody services. It should be a part of the exception from broker/dealer registration. Although used together, there is a significant legal difference between safekeeping and custody services. In a pure safekeeping function you simply hold the asset in a vault and assume no responsibility for any activity involving that asset. Scott on Trusts, the treatise by which Trust Departments have operated, has been developed over time incorporating English Common Law as well as case law. Common Law would certainly predate any of the Securities and Exchange Act Regulations starting with 1934. Section 8.1 of the Fourth Edition of Scott defines eight functions of a Custodian. Specifically item (8) in that list states "to buy, sell, collect, or deliver securities on specific directions of the customer". The American Institute of Banking confirmed these functions as well in 1944. Should the Commission persist with its thought that buying/selling securities is not a normal function of trust institutions providing custody services, it will have a significant and severe impact on IRA customers, retirement plan customers, cities, counties, boroughs, states, utility districts, foundations, charities, colleges, universities, and many federal agencies among others. All of these institutions take advantage of custody services provided by banks. Eliminating the ability to settle on the buying/selling

of securities as directed by the client could effectively eliminate this service as a line-of-business. As an example, our Bank processed over 15,100 Buys and over 25,000 Sells of Securities for the twelve months ending 8-1-04. This number does not include money market transactions. To restrict this service to the broker will eliminate many of the safeguards built into the system for the proper settling of trades, collection of income, maintaining original cost, amortized cost, tax lots, and current market value among others. Current GASB rules concern how securities have three numerical ratings from one to three. One, being the highest and most secure, is usually given to banks that hold Public Funds. Three is considered the most risky and is associated with funds held at brokerage accounts in their street name. It does not appear that your Proposed Regulations considered and certainly did not mention Public Funds other than in the context of a Qualified Investors Retirement Fund. One of the primary reasons banks are retained to provide custody services is to effectively and efficiently settle security trades. Without that service there would be little reason to retain a bank. Many large banks have specialized in providing custody services and this may cripple or seriously reduce a major line-of-business and adversely impact their revenues.

Under the proposed rule over 17% of our assets would potentially be classified as Custodial Accounts. Our total department revenue from these accounts exceeds $480,000. As stated earlier, we do not collect load fees of any kind.

On the issue of grandfathering existing custody accounts, will this hold true if the customer switches from one bank to a different bank in two years?

The definition of a "Qualified Investor" as proposed does not, as mentioned earlier, contain any reference to Public Funds or Taft-Hartley Funds. The dollar limits per type are so large that they are of no value to our bank and we would guess for most banks below $1 billion in asset size. None of our existing 1,200 accounts would qualify under the proposed Qualified Investor definition. We would love to have that size of account but they just don't exist for the normal community bank, especially those in rural communities.

The proposed definition of a Custody Account needs expanding especially as it intended to include IRA accounts. Regardless whether the bank is the Trustee or Custodian of an IRA, there are major additional duties required including

providing and maintaining current plan documentation, providing Designation of Beneficiary Forms, calculating and paying minimum distributions at least annually, reporting to the IRS and participants on contributions, distributions, and rollovers, setting up and maintaining IRA QDRO's, and providing a valuation for thinly or non publicly traded assets among other requirements. These duties add significant responsibility and potential liability for administering IRA accounts regardless of capacity and are far more encompassing than that of a pure custodian.

Rule 761. Small Custody Accounts. We commend the Commission on expanding the bank asset size to $500 million from $100 million. We would ask that this number again be reviewed with the possibility of increasing it to $1 billion. Another possibility for adjusting this asset size might be on the basis of asset growth that could come from both adding new accounts and additions to trusts as well as positive returns in the financial market. If you assumed a 5% annual growth factor (which would not be out of line), we would request the Commission consider this as an additional approach rather than leaving the $500 million number static or fixed. As mentioned earlier, we would request the Commission consider increasing the "sales revenue" from $100,000/annually to at least $250,000. At 25 basis points it only takes $40 million in assets to max out under the current proposed rules. One or two major 401(k) plans would use up the proposed exemption amount leaving no flexibility for any other type of accounts. Regarding fees for Custody Accounts, most assets are marketable securities that can be priced to include domestic and foreign equities, fixed-income assets and possible real estate. We normally charge an asset-based fee, but security transaction charges (note: the cost for these transactions vary significantly per institution based on size and volume), wire fees, fees for multiple accounts (managers), and 12b-1 fees for money market funds are almost always included in bids to provide this service. Banks may offer other non-custody products but usually not in exchange for reduced custody fees.

Institutional custody services are priced based on a response to a request for proposal submitted to the bank by a consultant or advisor for the fund seeking competitive bids for the service. Bids are usually requested from more than one institution to promote competition in the marketplace. Custody services are also marketed to individuals to introduce them to our staff and make them familiar with our services to include our financial reporting. We hope to eventually upgrade

them to more of our fiduciary services as their needs and confidence with us increases. Normally as the Custodian we do not offer any investment services, except for IRA accounts. It should be noted that the standard IRS documents (on which most institutions have relied, including the firms that provide a package of documents) for Trustee and Custodian accounts make no distinction on investment responsibility. The wording in the documents has been identical with the only difference being the substitution of Trustee for Custodian or the reverse. If the Commission proposes rules that create different responsibilities based solely on those two terms, a majority of IRA documents will need to be changed and responsibilities clearly defined throughout the documents. This would impact over 400 of our existing customers.

Rules 770-776. Employee Benefit Plans. A question of clarification involves the proposed definition requiring a bank to offset or credit any compensation it receives from a fund complex related to securities in which the plan assets are invested against fees and expenses that the plan owes the bank. Will this compensation be included in the $100,000 annual limit, even if offset in part or in total by these expenses?

We were unable to locate under the proposed Rule 770 the definition of retirement accounts that fit this exemption. We have found reference in other sources that indicate that IRA's, SEP's, Simple IRA's, stock bonus plans and money purchase plans are not included. If that is true, we are perplexed especially with the exclusion of money purchase pension plans. We would bring to the Commission's attention that many Multi-Employer Taft-Hartley programs have created Defined Contribution Plans and they use the majority of the features of a money purchase program. Single employer-sponsored plans have also been a significant form of retirement program although current usage is declining as they are currently being combined with other retirement plans to create just one Plan and Trust. We request your thoughts on why these plans and IRA's should be covered under the trust and fiduciary exemption rather than the employee benefit exemption?

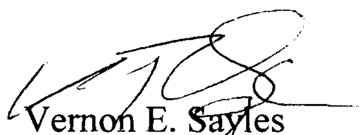
Our bank acts as both the trustee and non-fiduciary record keeper. This is not the norm as most community banks act only as the trustee. In our case we provide both services to fill a market void for local record keeping services. Our fees are in accordance with our published fee schedule, a copy of which is enclosed.

We process the majority of our trades through a mutual fund clearing service. It is important though that we also be exempted from trading directly with a funds transfer agent since some funds have elected not to clear through any of the clearing services. We compliment the Commission on expanding the exemption.

Rule 780-781. We can envision that a bank might suddenly hit the $500 million in assets due to significant gains in the securities market or even a temporary large cash or security deposit at some reporting date such as the calendar year. It is suggested that a phase-in period be established where a bank would need to exceed the $500 million asset base for, as an example, five of the six months prior to the scheduled reporting date or maybe for a minimum of two or three straight call reports. This would at least give the bank the opportunity to better prepare for the changes that will occur in the reporting process. Again, we would ask the Commission to consider increasing the threshold from $500 million to $1 billion. Based on the statistics you previously quoted this increase in asset base will most likely cover, percentage wise, only a few additional banks. This would provide assistance to banks like ours that do not have the people, systems or the resources available to do all the reporting that will be required.

We hope we have provided the Commission with information or questions that will benefit this process. Thank you for your consideration.

Sincerely,



Vernon E. Sayles
Senior Vice President
Trust and Financial Services Manager