September 1, 2004

By E-mail: rule-comments@SEC.gov

Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 5th Street NW
Washington, D.C. 20549-0609

RE: Proposed Regulation B (Release No. 34-49879, File No. S7-26-04 Federal Register 39682 (June 30, 2004))

Dear Mr. Katz:

U.S. Bancorp and its fiduciary businesses appreciate the opportunity to comment on Regulation B, the proposed rules regulating exceptions for banks from the definition of the term "broker" in Section 3(a)(4) of the Securities Exchange Act of 1934, as amended by the Gramm-Leach-Bliley Act of 1999 ("GLBA"). Regulation B was proposed by the Securities and Exchange Commission and published in the Federal Register on June 30, 2004.

U.S. Bancorp is the parent company of U.S. Bank National Association. We have two other trust company affiliates, a registered investment advisor affiliate, and two broker/dealer affiliates. U.S. Bancorp is the sixth largest domestic financial services holding company with $190 billion in assets. We provide trust and investment services to approximately 160,000 accounts through 173 offices in 25 states. We are among the top five largest providers of corporate trust services in the nation.

Our ability to comment on Regulation B is a direct result of the extension of the comment date to September 1, 2004. This extension allowed us time to more completely evaluate the potential impacts to our organization. We appreciate the SEC's extension of the comment period. We urge the SEC to issue a revised Regulation B for another round of public comment before issuing a final rule. Given the significant level of concern and commentary on the proposed rules, we believe it is imperative that an opportunity be provided for banks, industry organizations and other regulators to provide input on any revisions to the proposed rules. When final rules are issued, we believe it is imperative that banks are allowed a minimum of 18 months before compliance is required, to allow sufficient time to modify systems, policies and procedures as may be required by the rules. The effective date of compliance with Regulation B and any grandfather dates should be the same and also coincide with the start of a calendar year.

U.S. Bancorp is a member of The Clearing House and the American Bankers Association. We have participated in the drafting of, and we strongly endorse, the comment letters submitted by these organizations. In particular, we share the concerns expressed in those letters that the regulatory approach adopted by the SEC in Regulation B is inconsistent with the legislative intent of GLBA.

Although Regulation B is an improvement over the interim rules, we continue to believe that its provisions are unduly complex, administratively burdensome and will result in significant costs to banks that will most likely be passed on to bank clients. It continues to be our opinion that this new environment of bank regulation will not provide significant or material benefits or protections to bank clients. Historically, bank clients have enjoyed protections resulting from long established fiduciary standards under state and federal law, and the regulatory oversight provided by bank regulators.

**<u>Trust and Fiduciary Exception – Proposed Rules 720 - 724</u>**

In light of the complexity of Regulation B and the significant consequences of falling out of compliance with the Trust and Fiduciary Activities Exception we offer the following comments related to the line-of-business exemption. These comments are intended to simplify compliance and provide banks flexibility in compliance while continuing to respect the SEC's interest in investor protection.

1. We agree with the SEC's proposal to withdraw the definition of "trustee capacity" and not specifically identify trustee capacities that fall under this exception. Such attempts to define and identify trustee capacities would create additional uncertainties and ambiguities in an industry in which banks assume varying degrees of fiduciary responsibilities. The better approach is to look to the governing instrument and state and federal law to determine the nature of the fiduciary relationship.

2. Rule 724(i)(6) should be revised to clarify that fees paid for the services described in 724(i)(6)(i)-(vii) ("unrelated compensation") may be paid by the investment company or its affiliates, such as the investment advisor or distributor, as is customary in the industry.

3. We agree with the SEC's proposal to expand the definition of "relationship compensation" under Rule 724 to include fees for managing non-security assets such as real property, oil and gas, etc. In addition, we believe that "unrelated compensation" as a category of compensation for services provided to a client's account should be eliminated. Instead, such compensation should be considered "relationship compensation" for purposes of the proposed account-by-account or line-of-business exemptions (or considered within "total compensation" as discussed in our suggested "total compensation" approach discussed in 4 below.) This would include fees for services necessary to an account such as tax reporting and processing. It would also include fees received for the services listed in Rule 724(i)(6)(i)-(vii). This list of seven services includes services which the section specifically states are for "beneficial owners" (bank clients). Since unrelated compensation is received for services performed by the bank for clients as a direct result of the fiduciary relationship, it should also be considered "relationship compensation."

4. We believe that a better approach to complying with the line-of-business and account-by-account exemptions is to revise the proposed exemptions to compare "sales compensation" to all revenues received by a bank in connection with its trust and fiduciary activities. This

"total compensation" approach would simplify banks' testing in that only "sales compensation," rather than three different types of compensation (i.e. sales, relationship and unrelated compensation), would have to be independently tracked. We also believe that it is reasonable to apply the account-by-account "chiefly compensated" condition that a bank must receive "more relationship compensation than sales compensation" to the line-of-business exemption as well and require only that the ratio of "sales compensation" to "total compensation" be less than 50%.

5. We agree with the SEC's proposal that the line-of-business exemption be available on a bank-wide, departmental or unit basis. We understand this to mean that a bank may apply the sales compensation to relationship compensation ratio test as a line-of-business alternatively to: 1) all accounts for which it acts in a trustee or fiduciary capacity (i.e. combining personal trust, corporate trust and institutional trust accounts), 2) all accounts for which it acts in a trustee or fiduciary capacity within a particular trust business line (i.e. personal trust or institutional trust), or 3) certain similar accounts for which it acts in a trustee or fiduciary capacity within a particular trust business line (i.e. 401(k) plans, defined benefit plans, non-qualified plans or escrow accounts within an institutional trust line-of-business). Allowing a bank-wide test, with the alternative of testing on a departmental or unit basis if desirable, will provide banks with more options for simplifying the test and additional flexibility in compliance. It will also fulfill the SEC's interest in investor protection. To provide additional clarity, we suggest that the definition of "line-of-business" in Rule 724(e) be revised to read, "line-of-business means an identifiable department, unit or division (or grouping of similar accounts within such department, unit or division) of a bank organized and operated on an ongoing basis for business reasons."

6. In conjunction with our comments in 5, we also suggest that banks should be allowed to identify lines of business and then test those lines of business using either or both of the SEC's proposed methods, the ratio test or the account-by-account test. Allowing the use of both tests provides banks with more flexibility in compliance overall while fulfilling the SEC's interest in investor protection.

7. In conjunction with our comments in 5 and 6, we also suggest that the SEC clarify that banks which elect to use the line-of-business exemption may also apply any other Regulation B exemptions to that line-of-business. In other words, once a bank identifies a line-of-business, it should then be able to exclude from that line-of-business, for testing purposes, compensation that falls under other desirable exemptions. In allowing these other exemptions, the SEC must have concluded that the conditions of these exemptions provide adequate protection for the exempted accounts. Allowing the use of other exemptions within the line-of-business exemption would simplify testing and provide banks with more flexibility in compliance while fulfilling the SEC's interest in investor protection.

8. We believe that the account review procedures required under Rules 721 and 722 create an unnecessary burden on banks. Requiring banks to review accounts upon opening and at any time the bank negotiates with an account holder to increase the proportion of "sales compensation" as compared to "relationship compensation" has the effect of requiring banks to do calculations once on the account level and then again in the aggregate at the end of the year for the line-of-business calculation. The SEC seemed to agree that it was overly burdensome in the interim rules for banks to look at accounts on an account-by-account

basis when doing the chiefly compensated calculation and gave banks the opportunity to comply with an annual line-of-business test. Compliance with the annual chiefly compensated calculation fulfills the SEC's interest in investor protection without the need for a duplicative interim review of individual accounts.

**Sweep Accounts Exception – Proposed Rule 740**

We agree with the understanding expressed by the SEC in the narrative portion of the release that "banks are not prohibited by the statute's 'no-load' condition or our interpretation of it from directly charging their customers for sweep services." Therefore, we ask the SEC to revise Proposed Rule 740 to permit banks to be exempt from the definition of "broker" to the extent that they receive no more than reasonable compensation, regardless of source, for such services as determined under applicable fiduciary law. Alternatively, the SEC should adopt an exemption whereby banks will be exempt from the definition of "broker" to the extent that they sweep funds into money market funds (whether or not such money market funds meet the definition of "no-load" that the SEC is proposing). To the extent that the term "no-load" mutual fund is referenced elsewhere in Regulation B, such as in Proposed Rule 776, we suggest that comparable revisions apply.

**Safekeeping and Custody Activities Exception – Proposed Rule 760**

Regulation B is an improvement over the interim rules in that it allows banks to continue to receive securities orders and direct them to broker-dealers for execution for certain grandfathered custody accounts and qualified investor custody accounts. However, we continue to believe that the Regulation B provisions are unduly restrictive for custody accounts. We suggest that the custody exemption be further broadened to provide that banks may receive orders and direct them to registered broker-dealers in all custodial relationships subject to the conditions proposed in Rule 760 for grandfathered accounts.

Broadening the custody exemption is appropriate, in our opinion, because receiving and directing orders as custodian is a customary banking activity. Custody clients currently enjoy a high level of protection associated with securities trading and Proposed Rule 760 for grandfathered accounts provides additional protection for custody clients.

Receiving and directing securities orders has been an important aspect of the services we have long provided to our custody clients. We have received and directed orders as an accommodation and convenience to our clients within our customary custody services, not as an alternative to a brokerage account. Our clients, and prospective clients, want this service and generally expect this service. Although we receive and direct orders, we do not require clients to place orders with us, nor do we limit the registered brokers they may work with to place trades in their custody accounts. In other words, if a client places an order with us, it is by their choice because they do not want to complicate the relationship by adding an additional party. Also, since bank custodians are statutorily required to direct transactions to a registered broker-dealer, the only context in which such a directive makes sense is where the bank is taking orders from the custody client or its investment advisor.

Clients with custody accounts in a bank trust department setting also enjoy a high level of protection associated with the placement, execution and settlement of trades. Custodial relationships are by definition non-discretionary and therefore the bank cannot, and does not, determine when a trade will be made. The client or the client's advisors determine when a trade will be placed without solicitation from a bank employee. No commission is paid to bank employees who receive orders. When a bank receives an order from the client or its advisor, it does so as an administrative aspect of its custodial services. This trading structure often results in lower trading volume in custody accounts. In addition, in its capacity as custodian, the bank will provide the following services related to the trade: 1) ensure that the correct securities are delivered, 2) ensure that the securities are properly accounted for, 3) ensure the proper price was paid, and 4) provide statements to the client. It is important to keep in mind that all this activity takes place in an environment of full disclosure as to fees and servicing arrangements as required by fiduciary standards under state and federal law, and bank regulators. In this environment, although it is the client's prerogative, it does not appear that the client would receive any additional protection by placing the trade directly with the broker-dealer.

It is also important to keep in mind that there are differences between the services a client may expect from a bank custody relationship and a brokerage relationship. These differences often influence the client's decision as to whether to open a custody or brokerage account. For example, typical services provided in a bank custody relationship, which are not provided in brokerage relationships, include class action processing, principal and income accounting, consolidated income tax reporting, foreign tax reclamation, income collection and reconcilement, performance reporting, risk analysis and corporate action processing. Another critical difference in services is that banks are not limited in the type of assets they may hold. A custody account may hold securities as well as non-security assets such as deposit instruments, notes, real estate and physical commodities. If banks are prohibited from receiving orders in custody accounts, clients will be denied the right to choose a single provider situation that has historically met their needs. Many clients will be forced to open additional brokerage accounts to trade securities when they could previously conduct all their business and trading through a single account. Opening such additional accounts may also increase the complexity of the client's tax reporting as consolidated tax reporting will not be available.

Additionally, it is critical that bank custodial IRA services be expressly exempted as this is required in GLBA and the well-documented legislative intent of GLBA on this point. If a bank could not receive orders to purchase or sell securities within IRAs, the language in GLBA allowing the exemption would be irrelevant and meaningless (which was certainly not the intent of Congress). In addition to this necessary clarification and revision, this rule should acknowledge the applicability of the rule to other employee benefit custodial accounts including IRA-like custodial accounts, such as health savings accounts, Coverdell education savings accounts as well as any successors to these accounts.

Finally, we believe that the SEC's proposal for grandfathering current custody accounts under Rule 760 provides, for those accounts, the protection desired by the SEC while continuing to respect the accommodative and historical nature of the limited securities business that banks have customarily performed for their custody clients. As such, we also believe that Rule 760 should be extended to all custody accounts. In conjunction with the protections described above, Rule 760 provides a workable solution for banks to continue to provide custody clients services they are accustomed to while respecting the SEC's interest in investor protections associated with trading activity.

**Employee Benefit Plans Exemption – Proposed Rule 770**

While we appreciate that the SEC has included the Employee Benefit Plan Exemption, Proposed Rule 770, this rule should be expanded to cover all types of qualified and non-qualified retirement/deferred compensation/tax savings plans. Plans that are not qualified plans under Internal

Revenue Code Section 401(a) are serviced through the employee benefit plan divisions of banks that also service IRC Section 401(a) qualified plans. Some examples of such plans are deferred compensation plans (including those held in rabbi trusts and secular trusts), voluntary employee beneficiary association plans, certain church and governmental retirement plans and individual retirement accounts (including IRA-like accounts such as health savings accounts, Coverdell education savings accounts and any successors to these accounts). Because the deferred compensation, savings, trust and investment objectives of these plans are comparable in many ways to those of IRC Section 401(a) qualified plans, clients look to banks to provide comparable employee benefit plan services for these plans (including trustee, custodian and non-fiduciary administrator) under similar fee arrangements. Including such non-qualified plans under Rule 770 will allow banks that service these plans in an employee benefit plan division under similar servicing and fee arrangements as qualified plans to comply from a bank division or business line standpoint with the same, relevant rule under Regulation B.

Proposed Rule 770 incorporates the Department of Labor's ("DOL's") "Frost Letter" (ERISA Advisory Opinion 97-15A) as the sole guidance with respect to required fee offset or credit requirements applicable to employee benefit plan servicing arrangements. However, while the Frost Letter may be relied upon by the banking industry for discretionary trustee arrangements (as intended by the DOL), the DOL's "Aetna Letter" (ERISA Advisory Opinion 97-16A) established fee arrangement requirements for situations where a bank serves as directed trustee. Banks typically serve in the capacity of directed trustee with respect to 401(k) plans, though discretionary trustee services may also be available. "Discretionary trustee" services are investment fiduciary services where, generally, the trustee has the right under a plan's governing documents to add, delete or substitute mutual funds under the plan's investment menu. Under "directed trustee" arrangements, a plan's governing documents delegate the fiduciary responsibility to add, delete or substitute mutual funds under the plan's investment menu to the plan's "named fiduciary," (i.e. the plan's sponsoring employer). The applicability of the Aetna Letter to banks was expressly addressed in the Information Letter from Bette J. Briggs, PWBA, DOL to Judith A. McCormick, American Bankers Association, dated August 20, 1997 (the "McCormick Letter") and further confirmed in the DOL's "ABN AMBRO Letter" (ERISA Advisory Opinion 2003-09A).

The Frost Letter's requirements of specific fee offsets and credits that are applicable only to banks serving as discretionary trustees should not be established by the SEC as the sole rule in this area. We suggest that the SEC should defer to applicable federal or state law, including applicable DOL guidance with respect to ERISA requirements that protect plans and their participants from impermissible and excessive fee arrangements. For example, for ERISA plans this approach would address disclosure requirements, since ERISA standards require disclosures of fee arrangements and independent fiduciary approval of such arrangements.

Finally, Rule 770 should expressly provide that it applies to banks that serve employee benefit plans as trustees, custodians or non-fiduciary administrators.

**<u>Money Market Funds Exemption – Proposed Rule 776</u>**

We appreciate the SEC's Proposed Rule 776 whereby a bank will be exempt from being defined as a broker when it effects transactions in money market mutual funds under certain circumstances. The SEC's willingness to expand the exemption to include such roles as an escrow agent and collateral agent is a welcomed proposal to the trust industry. As the Release notes, this exemption will be helpful in allowing banks to have greater flexibility to provide cash management services to their customers. While we appreciate the scope of the Rule 776 exemption for investment in money market funds, we ask that Proposed Rule 776(a) be revised to allow a bank, acting specifically in a role as required under Rule 776, to make trades in all types of securities pursuant to this general purpose exemption. Banks are allowed to trade only in securities as set forth in the governing documents. Allowing banks to trade in securities, including but not limited to: U.S. Government and U.S. Agency securities, commercial paper, repurchase agreements, short term bond funds, guaranteed investment contracts, corporate debt securities and municipal bonds, would avoid disruption and inconvenience to bank clients in cash management services for trust accounts. Clients of banks who act as trustees, escrow agents, collateral agents, depository agent or paying agents currently use banks to execute purchases, sales and redemptions of such securities, as well as money market mutual funds. Broadening the definition of securities would allow banks more flexibility in providing cash management services to its clients and would not compromise the SEC's concern of protecting investors. This requested revised exemption would allow banks to purchase, sell or redeem more types of securities without the undue need to make its customers use a licensed broker to facilitate such purchases, sales or redemptions.

We also ask that the scope of Rule 776(a)(1) be expanded to include not only "qualified investors" but also "accredited investors" as such term is defined in Rule 501 of the Securities Act of 1933. This broadening of the rule would allow banks to use the exemption for a wider range of sophisticated investors who are able to make informed investment decisions. We believe that the financial conditions and background that an investor must meet to be considered an "accredited investor" are similar to those required of a "qualified investor" and the types of securities that may be traded under Rule 776 provide the investor protections the SEC is interested in.

Again, we thank you for the opportunity to comment on the rule and explain the impact to our institution. We hope our suggestions for revision are helpful.

Sincerely,

Satish G. Pattegar
Senior Vice President
Chief Compliance Officer – Trust
U.S. Bank N.A.