July 16, 2001

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

Re: File No. S7-12-01

Dear Secretary Katz:

The North American Securities Administrators Association ("NASAA")[1] respectfully submits the following comments regarding the Securities and Exchange Commission's (the "Commission") Interim Final Rules for the Definition of Terms in and Specific Exemptions for Banks, Savings Associations, and Savings Banks under Sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934 (the "Rules").

Like the Commission, NASAA was involved in the development of the Gramm-Leach-Bliley Act ("GLBA"). Throughout its congressional testimony and other participation in the legislative process, we advocated for the concept of "functional regulation," under which regulation would be carried out pursuant to function rather than structure. Ultimately, functional regulation became the foundation upon which the GLBA was built.[2] In particular, Congress sought to establish functional regulation of bank securities activities.[3]

In formulating the system of functional regulation, Congress realized that banks may have to change the ways in which they carry out securities activities and "push out" certain activities to licensed broker-dealers.[4] Thus, the litmus test for the Rules is not whether or not they cause banks to change the way they do business, but whether or not they carry out Congressionally mandated functional regulation.

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[1] The oldest international organization devoted to investor protection, the North American Securities Administrators Association, Inc., was organized in 1919. Its membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico and Puerto Rico. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.

[2] *See* Joint Explanatory Statement of the Committee of Conference, contained in H. Rept. 106-434, at p. 151.

[3] *Id* at 163. *See also* H. Rept. 106-74, part 3, at p. 162.

[4] For example, Senate Report 106-44 expressly addresses the "push out" issue in its "Cost Estimate" section. At page 49, the Report states: "A substantial number of banks that currently handle securities activities have a broker-dealer affiliate so that the incremental cost of complying with SEC regulation would involve moving non-exempt activities to such an affiliate *and would not be significant.*" (Emphasis added.)

Because the Rules carry out functional regulation, not only are they appropriate, they are consistent with the Congressional intent expressed in the GLBA. Consequently, we fully support the Rules. In addition to our general support, we offer the following comments in support of certain specific provisions of the Rules.

Networking Exception

The express language of the statutory networking exception added by the GLBA prohibits an unlicensed bank employee from receiving "incentive compensation" for any brokerage transaction. An exception to this prohibition permits a "nominal one-time" payment. In light of this express statutory language, we believe that Rule 3b-17(g) is appropriate. Rule 3b-17(g) ensures that payments will be "nominal," as mandated by Congress, and at the same time provides flexibility by incorporating two alternative standards. Further, we agree that "bonus" payments are wholly inconsistent with the Congressional prohibition on incentive payments.

Trust and Fiduciary Activities Exception

This is perhaps the most complex of the exclusions from the definition of "broker" added by the GLBA. The number of conditions placed on this exclusion reflects the Congressional intent that it be narrow in scope.[5] Otherwise, banks could use this exclusion for full brokerage activities under the guise of a "private banking" or other similar program. Of course, such activity would be inconsistent with functional regulation and contrary to Congressional intent.[6]

Notwithstanding the narrow scope of this exclusion, we applaud the Commission for adopting Rule 3b-17(k), which provides a definitional exception for certain trustee activities. Although this provision was not required by the GLBA, we anticipate that the banking industry will appreciate the alleviation of this legal uncertainty.

We agree that the trust and fiduciary exception does not extend to securities activities that a bank transfer agent conducts with the shareholders of an issuer that resemble those of a broker-dealer. We believe that Rule 3b-17(d) is appropriate since it is consistent with current investment adviser law.

Further, in our view, the provisions regarding "chiefly compensated" hit the mark in defining arrangements that are within the trust and fiduciary activities exclusion. By comparing "relationship compensation" and "sales compensation," the provisions ensure that traditional trust activities may remain in the bank, while activities in which the bank has a "salesman's stake" are pushed out.[7] Anything less than an account-by-account calculation would create the

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[5] H. Rept. 106-434 at p.163 ("The Conferees retained certain limited exemptions…").

[6] *See* H. Rept. No. 106-74, part 3, at p. 164.

[7] Congress intended that activities in which there is a "salesman's stake" be "pushed out." *See* H. Rept. 106-74, part 3, at p. 164.

potential for a bank to use the trust and fiduciary activities exemption to conduct brokerage activities outside the securities laws through a "private banking" or similar program.

In general, we believe that the provisions regarding the trust and fiduciary exception appropriately implements functional regulation while at the same time following the Congressional instruction "not [to] disturb traditional bank trust activities."[8]

Sweep Accounts Exception

In light of the GLBA's use of "no-load" in the statutory sweep accounts exception, we believe that adoption of the NASD's definition of "no-load" is the logical and appropriate way to clarify this exception.

Safekeeping and Custody Activities Exception

As the commentary accompanying the Rules points out, Congress did not intend the safekeeping and custody activities exception to allow banks to engage in broader securities activities. Indeed, Congress intended this exception to extend only to "limited and incidental activities."[9] Therefore, we agree that "custody" or "related administrative services" do not include accepting orders from investors to purchase or sell securities. Order acceptance is a *sine qua non* of broker-dealer activity, and to allow order acceptance within the safekeeping and custody activities exception would be inconsistent with functional regulation.

Exemption for Banks from Section 29 Liability

We commend the Commission on establishing a limited exemption for banks from rescission liability under the Securities Exchange Act. While not mandated by the GLBA, this provides important legal protection while banks come into compliance with new functional regulation structure.

NASAA appreciates the opportunity to comment on the Rules. Because the Rules carry out functional regulation, not only are they appropriate, they are consistent with the Congressional intent expressed in the GLBA. Please do not hesitate to contact me at 360-902-8797 if we can provide you with additional information.

Sincerely,

Deborah R. Bortner
NASAA President

cc: Acting Chairman Laura S. Unger
Commissioner Ike Hunt
Catherine McGuire, Associate Director/Chief Counsel, Division of Market Regulation
Lourdes Gonzalez, Assistant Chief Counsel, Division of Market Regulation

[8] H. Rept. 106-434 at p. 164.

[9] H. Rept. 106-74, part 3, at p. 168.