NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.

NASAA

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Jonathan Katz, Secretary
U.S. Securities and Exchange Commission
450 5th Street NW
Washington, DC 20005

Via e-mail to: rule-comments@sec.gov

Re: File No. S7-26-04, Proposed Regulation B

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") proposed Regulation B, promulgated under the Gramm-Leach-Bliley Act ("GLBA") which provides for new exemptions and broadens existing ones for banks, savings associations, and savings banks with regard to the term "broker" under Sections 3(a)(4) of the Securities Exchange Act of 1934 ("Exchange Act"). In addition, Regulation B provides a conforming amendment to an Exchange Act rule that grants a limited exemption from the broker-dealer registration requirement for foreign broker-dealers.

Throughout the legislative development of the GLBA, including congressional testimony and other participation in the legislative process, NASAA advocated for the concept of "functional regulation," whereby 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] Congress noted that "the limitations on bank securities activities have eroded as a result of administrative actions by Federal banking regulators. The rationale for the exemptions in the Federal securities laws that apply to banks is, thus no longer sound, given the extensive and increasing securities activities in which banks are engaging." (H. Rept. 106-74, Part 3, Financial Services Act of 1999 [to accompy H.R. 10], June 15, 1999, pp. 113-14). Consequently, the

[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's members are 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.

GLBA replaced the blanket exemption from securities regulation with a set of narrow exceptions for banks engaged in broker activities.

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 Regulation B should not be whether the regulation causes banks to change the way they do business, but whether the regulation carries out Congressionally mandated functional regulation.

In general, Regulation B promotes functional regulation consistent with the Congressional intent expressed in the GLBA. While NASAA believes that the Interim Rules were appropriate and not unduly burdensome, we support Regulation B in general and offer the following comments regarding certain specific provisions.

Networking Exception

The express language of the statutory networking exception added by the GLBA prohibits an unregistered bank employee from receiving "incentive compensation" for any brokerage transaction. An exception to this prohibition permits a "nominal one-time cash fee of a fixed dollar amount" for referring bank customers to the broker-dealer. NASAA believes that this amendment is appropriate, but that the proposal as structured is complicated and may warrant further clarification. We also believe that the regulation can be simplified and result in less complicated accounting and regulatory examination procedures if the referral fee calculation and payment in cash is made pursuant to the provisions of §240.710(b)(1) only, and by striking §240.710(b)(3) entirely from the proposed regulation.

Regulation B also proposes to amend the Interim Rules concerning what constitutes a "referral" by simplifying the definition in a manner consistent with pre-GLBA networking arrangements. The amended definition of "referral" would mean the action taken by a bank employee to direct a customer of the bank to a registered broker or dealer for the purchase or sale of securities for the customer's account. We recognize that under this definition a bank employee can receive a nominal fee only one time per customer, and thus, we accept the "action taken to direct" concept as proposed in Regulation B. However, we oppose any further broadening of the activity that constitutes a "referral" for purposes of bank employees receiving incentive compensation.

Trust and Fiduciary Account Exception

As we mentioned in our previous comment letter dated July 16, 2001, 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 to conduct 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]

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[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.)

[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.

Notwithstanding the narrow scope of this exclusion, we applaud the Commission for adopting the Interim Rules, and now for proposing Regulation B, which provides a definitional exception for certain trustee activities. Although not expressly mandated by the GLBA, this provision is a positive step because it provides more legal certainty to the banking industry.

We agree that the trust and fiduciary exception should not extend to securities activities that a bank transfer agent conducts with the shareholders of an issuer that resemble those of a broker-dealer. This is appropriate since it is consistent with current investment adviser law.

As NASAA has stated earlier, the provisions of proposed Regulation B regarding "chiefly compensated" properly define 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] We are also mindful, however, of the burden that implementation of the Interim Rules creates, and that Regulation B proposes several amendments intended to facilitate bank compliance. We continue to maintain that anything less than an account-by-account calculation would create the 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. We are not opposed to the amendments to expand the definition of "relationship compensation" because it appears that they do not compromise investor protection.

Bank Custody Exception

As we mentioned in our previous comment letter, the commentary accompanying the GLBA points out that Congress did not intend for 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."[8] Therefore, we agree that the terms "custody" or "related administrative services" do not include the acceptance of orders from investors to purchase or sell securities. Order acceptance is a fundamental broker-dealer activity, and to allow order acceptance within the bank custody activities exception would be inconsistent with functional regulation. Similarly, we do not believe that bank employees should be directly or indirectly compensated through 12b-1 fees or any other fees related to transactions other than the statutorily permitted nominal one-time cash referral fee of a fixed dollar amount.

NASAA prefers the Interim Rules that provided banks with two exemptions—one for small banks and one for all banks. Both exemptions are consistent with functional regulation in that they contain solicitation, compensation, and staffing limits designed to allow banks acting as a custodian to engage in a small number of accommodation trades that do not amount to large-scale brokerage activity without the investor protections under federal securities laws. We believe that Regulation B may have gone too far in the expansion of the definition of small banks and may result in more large-scale brokerage activity than contemplated under the GLBA. In addition to investor protection issues, Congress also expressed its concern that certain exemptions have created a disparity between competitors in the financial services marketplace by

[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.

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

permitting banks to engage in securities activities without being subject to the same regulatory requirements that apply to broker-dealers. [9]

Sweep Accounts Exception

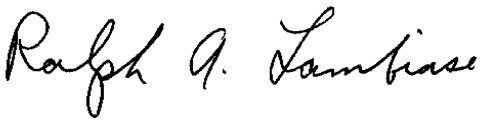
In light of the GLBA's use of "no-load" in the statutory sweep accounts exception, we continue to maintain that adoption of the NASD's definition of "no-load" is the logical and appropriate way to clarify this exception. Furthermore, we agree with the Commission that investors have come to rely on this term as denoting not more than minimal 12b-1 fees, and that there are no front-end or deferred sales charges. Therefore, we support the Regulation B amendments because they are consistent with common industry and investor understanding and do not appear to disturb the current definition.

Conclusion

NASAA appreciates the opportunity to comment on Regulation B. Investors purchasing securities through banks, savings and loans, credit unions, and thrift institutions are entitled to receive the same protections afforded to them when they purchase securities through broker-dealers. The regulations governing broker-dealers have evolved over many years of experience and countless transactions in securities resulting in a high degree of integrity in the market and a practical investor protection regulatory regime that is not unduly burdensome. Consequently, NASAA supports Regulation B but believes that the regulation may require further strengthening, especially if future application of the rules indicates that investors need greater protection.

In general, the proposed rule promotes functional regulation as intended by the GLBA and NASAA supports the rule. Please do not hesitate to contact either Tanya Solov, chair of the NASAA Broker-Dealer Section at (312) 793-3384, or Ryan Ushijima, chair of the NASAA Market and Regulatory Policy and Review Project Group at (808) 586-2744, if you have any questions or would like additional information.

Sincerely,



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[9] *See* H. Rept. 106-74, Part 3, pp. 113-14.