

**Securities Industry Association**

120 Broadway, New York, NY 10271-0080, (212) 608-1500, Fax (212) 608-1604
1401 Eye Street, NW, Washington, DC 20005-2225, (202) 296-9410, Fax (202) 296-9775
info@sia.com, <http://www.sia.com>

March 5, 1997

Communications Division
Office of the Comptroller of the Currency
250 E Street, S.W.
Washington, D.C. 20219
Attention: Docket No. 96-29

William W. Wiles
Secretary
Board of Governors of the Federal Reserve System
20th and Constitution Avenue, N.W.
Washington, D.C. 20551
Attention: Docket No. R-0950

Jerry L. Langley
Executive Secretary
Attention: Room F-402
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

Re: Comment Letter of the Securities Industry Association Concerning the Joint Notice of Proposed Rulemaking Entitled "Qualification Requirements for Transactions in Certain Securities"

Ladies and Gentlemen:

I. INTRODUCTION AND SUMMARY

The Securities Industry Association ("SIA") **1** appreciates the opportunity to present its comments on the proposals in the above-referenced Joint Notice of Proposed Rulemaking (the "Joint Notice"). SIA supports the individual proposals in the Joint Notice, because SIA believes that customers would be better served under the proposals than they are currently. Nonetheless, SIA believes that customers would be far better served under a system of functional regulation, pursuant to which bank securities activities would be subject to regulation by the Securities and Exchange Commission (the "SEC"), and by the National Association of Securities Dealers, Inc. (the "NASD") and the other securities self-regulatory organizations ("SSROs"), just as is every non-bank securities firm in the United States. **2**

SIA recognizes that the banking agencies cannot by themselves create a system of functional

regulation, and that such a system can only be created by Congress in the context of comprehensive financial services modernization legislation. Nonetheless, consistent with the theme of functional regulation, the banking agencies can and should expand their proposals to more effectively achieve the underlying purpose of the proposals -- to assure that investors who buy and sell securities through banks are subject to the same substantive protections as are investors who buy and sell securities through all other securities firms in the United States. Specifically:

- Supervisors of bank registered representatives should be required to take and pass the appropriate NASD examinations for supervisors.
- The banking agencies should attempt to arrange for the NASD to become the self-regulator of banks that engage in securities activities, just as it is the self-regulator for the remainder of the securities industry.
- The banking agencies should attempt to arrange for SEC inspectors to examine banks that engage in securities activities (either with bank examiners or separately), to assure that the regulatory and enforcement priorities of the SEC are adequately represented in the bank examination program, and to help assure that all entities in the United States that sell securities are subject to similar oversight.
- Bank customers should receive disclosures of the significant differences in regulation of bank sales of securities and sales of securities by registered broker-dealers.

In order to put SIA's comments and recommendations in context, this letter will (after summarizing the proposals) discuss why SIA believes that functional regulation is of such critical importance to consumers and to competitive fairness. This letter will then discuss each of SIA's suggestions for broadening the proposals.

II. SUMMARY OF PROPOSALS

The proposals impose three principal sets of requirements

First , bank securities representatives must take and pass the Series 6 or Series 7 examination (as appropriate, based on their sales activities), which are administered by the National Association of Securities Dealers, Inc. (the "NASD"). Bank securities representatives are defined as bank officers, directors, or employees (collectively, "employees") who sell certain types of securities, or who are designated as the supervisor of a bank employee who sells such securities.

Second , banks that will engage in selling securities (referred to as "sponsoring banks") and their bank securities representative will participate in the NASD's Central Registration Depository ("CRD") in substantially the same manner as do registered broker-dealers and registered representatives.

Third , sponsoring banks and bank securities representatives must meet certain continuing education standards that are intended to be comparable to the requirements for registered broker-dealers:

III. FUNCTIONAL REGULATION OF BANK SECURITIES ACTIVITIES IS CRITICALLY IMPORTANT FOR CUSTOMER PROTECTION AND COMPETITIVE FAIRNESS

The U.S. securities markets are the deepest, largest, most transparent and most liquid in the world. This has resulted in no small measure from the high degree of confidence the investing public -- both domestically and internationally -- has in the regulation of the U.S. securities markets. This confidence, in turn, rests largely on the genius of the full disclosure philosophy of the Securities Act of 1933 and the Securities Exchange Act of 1934, and on the diligence of the SEC, the NASD and the other SSROs in enforcing the federal securities -- both of which have as their central purpose the goal of investor protection. The current system of differential regulation -- pursuant to which all nonbank securities firms in the United States are regulated by the SEC, the NASD and the other SSROs, while banks that engage in securities activities are subject to the regulation of the federal banking agencies -- threatens to eventually undermine investors' confidence in our system of securities regulation, and in securities markets themselves.

Currently, tens of **billions** of dollars **each month** flow into mutual funds sales in the United States. **Billions** of dollars more each year flow into the United States securities markets from overseas. The securities industry is a dynamic, growing industry that involves the coordination and regulation of issuers, brokers, dealers, underwriters, investment companies, investment advisers, stock and option exchanges, specialists, private securities systems, clearance and settlement systems, transfer agents, custodians, securities depositories and countless other market participants. While banks traditionally have participated and increasingly are participating in the securities markets, there is no debate over the fact that the principal regulators of the securities markets have been and are the SEC, the NASD and the other SSROs. The U.S. securities markets have enjoyed incredible success under the regulatory stewardship of these entities -- for example, without a penny of tax-payer funded deposit insurance and under the regulation of only a single division of the SEC, assets invested in mutual funds now exceed the assets held in the banks regulated by all of the federal banking agencies combined. Given this success, it clearly is not in the best interests of the securities markets or investors to permit a separate bank securities industry to develop outside of the regulatory jurisdiction of the SEC, the NASD and the other SSROs. And, it makes no sense at all to permit the three separate banking agencies to in effect create three different regulatory systems governing bank securities activities.

Nor is it fair to suggest that the provisions in the federal securities laws exempting banks from SEC regulation evidence a Congressional determination that the types of securities activities in which banks currently engage should be exempt from SEC and NASD regulation. In 1933 and 1934, when Congress enacted the federal securities laws and excluded banks from SEC regulation, banks were in fact prohibited from engaging in any securities activities, except those expressly authorized by statute. Pursuant to the Glass-Steagall Act -- which was enacted in 1933, the same year as the first of the federal securities laws was enacted -- national and state-chartered member banks were limited to buying and selling Government and other bank-eligible securities, engaging in brokerage activities in connection with legitimate trust activities, and engaging in similar types of securities activities. Congress' decision in the 1930s to exempt banks from SEC regulation fairly must be viewed as a policy judgment that SEC oversight was not necessary with respect to the limited securities activities in which banks then were permitted to engage, particularly since those activities historically had been performed by banks, and historically had been regulated by banking regulators. Since the 1930's, however, the federal banking regulators have greatly expanded the types of securities activities in which

banks are now permitted to engage, so that banks may now engage in brokerage, investment advisory and various other securities activities. To our knowledge, Congress has never has made an affirmative legislative determination that these types of securities activities, when performed in a bank, should be exempt from SEC oversight.

SIA is aware that the banking regulators have a legitimate need to assess whether the securities activities of a bank in some way affect that bank's safety and soundness. This, however, is not an argument for displacing the regulatory jurisdiction of the SEC, because the banking regulators' need to assess and maintain the safety and soundness of a bank does not supplant the SEC's interest in assuring that investors are adequately protected. Rather, a bank that engages in securities activities must do so without jeopardizing its safety and soundness, **and** must engage in those activities in a manner designed to ensure the protection of investors.

SIA therefore believes that when a bank elects to engage in securities activities, it should be required to accept as a "cost" of that decision that the SEC and the NASD will regulate those securities activities. This is the case with every other entity in the United States -- including highly regulated entities such as insurance companies. SIA also believes that SEC and NASD oversight would not impose significant additional regulatory layers on banks. In theory, banks already are required to comply with the federal securities laws, and in theory bank regulators already supervise those securities activities. The SEC and the NASD would replace the bank regulators, solely with respect to the bank's securities activities. To the extent the bank regulators needed information about the bank's securities activities in order to assess the safety and soundness of the bank, that information presumably should be readily available from the SEC examination, and it is unlikely that the bank regulators generally would be required to duplicate much of the work done by the SEC examiners. To the extent that some additional regulatory burdens would be placed on a bank, those burdens would be precisely the same burdens that every other member of the securities industry is required to bear in the interests of investor protection.

SIA also does not believe that banking regulators reasonably can perform the same oversight of bank securities activities as the SEC and the NASD perform for the rest of the securities industry, for at least four reasons. *First*, banking regulators view a bank's securities activities through the prism of their mandate to assure the safety and soundness of the bank, while the SEC and the NASD view all other firms' securities activities based on the protection of investors. These different focuses are incompatible. It is akin to suggesting that, if a securities firm were to obtain the power to accept insured deposits, the firm's deposit-taking activities should be regulated by the SEC and the NASD within the general framework of determining whether the firm adequately was protecting investors, rather than by banking regulators who would look to the safety and soundness of the firm. Clearly, the banking regulators are correct to focus on safety and soundness, and the securities regulators are correct to focus on investor protection. But it is a mistake to think that a banking regulator focusing primarily on safety and soundness concerns can also focus on investor protection concerns to the same extent as could the SEC and the NASD. Just as it would be a mistake to think that the SEC, while focusing on investor protection concerns, also could focus on safety and soundness concerns to the same extent as could a bank regulator.

To take just one example, the safety and soundness of a bank may be enhanced by a bank directing its brokerage orders to particular firms or market centers (such as related firms, or

firms with which it has business relationships). A bank regulator thus in theory, and perhaps in practice, could be less diligent than the SEC or NASD in requiring that bank to regularly check to assure that it was receiving best execution from those firms or market centers.

Second , the SEC is the most knowledgeable U.S. regulator of securities firms and securities issues. This is true even though the banking regulators often deal with securities firms and securities related issues. The SEC, as the primary U.S. regulator of the securities markets and their participants, has considerably greater expertise in regulating securities firms and securities activities than do the banking agencies. For instance, in the example discussed above, it is likely that the SEC, because of experience in the securities markets, and its access to information about the securities markets (such as trade runs and similar information), is in a better position than the banking agencies to determine whether particular market centers are providing best execution.

Third , the SEC's ability to consistently and uniformly apply the Federal securities laws, and to achieve its regulatory priorities, is substantially weakened by its inability to examine and regulate the securities activities of banks. In this regard, bank examiners often will not place the same priority on certain securities-related issues as would SEC examiners. Among other reasons, the SEC's regulatory and enforcement priorities may not be adequately communicated to the bank examiners, and may not take on the same significance to the banking regulators (who have their own regulatory priorities) as they do to the SEC. In addition, bank examiners may not have the market-wide experience in the securities industry that SEC examiners possess (such as the interaction of brokerage firms with underwriters, investment advisers and mutual funds, and other financial participants). As a result, bank examiners are unlikely to be in a position to conform their inspection priorities and scope to SEC inspections.

For instance, in the example discussed above, the SEC (as well as the NASD and the other SSROs) have focused and continue to focus a great deal of attention on best execution issues. Among other things, the SEC recently adopted a number of rules that relate to best execution, including rules requiring market centers to include certain customer limit orders in their quotes or in certain electronic communications networks ("ECNs"), and prohibiting certain market participants from placing bids or offers in ECNs at prices better than their publicly available quotes. The SEC, and the NASD and other SSROs, also have issued a considerable amount of formal and informal interpretive guidance concerning the implementation of these rules. In addition, the SEC and its Staff recently have formally and informally discussed the evolving nature of the best execution obligation in light of advances in communications and technology, and have taken several interpretive positions regarding these obligations. The SEC and the ASD so are focusing on the effect of ECNs on the obligation of other market participants to obtain best execution. The SEC's ability to assure market-wide adherence to the evolving best execution obligation is significantly weakened by its inability to assure that banks are aware of and are meeting the various obligations to which all other market participants are subject, to the ultimate detriment of investors (and particularly people who invest through banks).

Fourth , the SEC's ability to inspect and regulate securities firms is greatly enhanced by the NASD, which, subject to SEC oversight, has significant responsibility in many areas for regulating registered broker-dealers. Of particular relevance to the issues raised by the Joint Notice is the fact, for example, that the NASD regulates securities firms' sales practices, and has a significant number of rules and regulations governing sales practices. Banks are not

subject to the NASD's jurisdiction or rules, just as they are not subject to the SEC's jurisdiction and rules.

More generally, the NASD provides a layer of industry self-regulation -- which includes extensive rules governing market practices, inspections and examinations of broker-dealers, testing and licensing requirements, and various other regulatory functions -- **above and beyond** the regulation provided by the SEC. In the Maloney Act, which in 1938 added Section 15A of the Securities Exchange Act of 1934, Congress determined that investor protection was best served by requiring the securities industry to be subject to this additional layer of industry self regulation, pursuant to which the industry could and would impose on itself regulatory standards that exceed those that the SEC lawfully could impose. Since shortly after the enactment of the Maloney Act, the NASD has been the industry's self-regulatory organization. The SEC's recent settled enforcement action against the NASD, in which the SEC alleged that the NASD failed adequately to enforce its rules and the federal securities laws against certain market participants, demonstrates the important regulatory role of the NASD, and the fact that the SEC expects and will take action to assure that the NASD properly will perform this role.

The inability of the NASD to examine and regulate bank securities activities results in the banking regulators exercising significantly less regulatory oversight with respect to banks than the SEC and NASD exercise over broker-dealers, both by removing the substantive protections afforded by NASD rules, and by removing the protections inherent in NASD examinations and enforcement.

SIA believes that, ultimately, these disparities hurt consumers, who legitimately may expect that their purchases and sales of securities through banks will be regulated in the same manner as, and will be subject to the same protections as, purchases and sales of securities through registered broker-dealers. SIA also believes that these regulatory disparities create unfair competitive advantages for banks that sell securities, as compared to registered broker-dealers. **3** In this regard, we note that a bank in effect can choose which regulatory scheme it would like to govern its retail securities activities, and can avoid SEC and NASD regulation by moving those securities activities out of a subsidiary and into the bank (as, for example, SunTrust Banks recently did).

In sum, SIA believes that sales of securities should be regulated by the SEC, regardless of whether those activities are conducted within or outside of a bank, just as working conditions of a place of business should be subject to the regulations of the Occupational Safety and Health Administration, regardless of whether that place of business is a bank.

IV. THE BANKING AGENCIES SHOULD SIGNIFICANTLY BROADEN THEIR PROPOSALS

SIA is aware that full functional regulation cannot be accomplished by the banking agencies, and ultimately must be mandated by Congress in the context of legislation comprehensively modernizing the financial services industry. SIA firmly believes that legislative action to mandate full functional regulation of securities activities is necessary, and SIA supports the efforts of some members of Congress who are attempting to achieve this result. Nonetheless, some of the regulatory disparities caused by the current system of differential regulation can and should be addressed by expanding the proposals in the Joint Notice.

First , supervisors of bank registered representatives should be required to take and pass the

appropriate NASD examinations for supervisors (or principals). The Joint Notice, which expressly requested comment on this issue, noted that General Securities Principal's Examination (Series 24) may not be appropriate for supervisors of many bank securities departments, because that examination covers investment banking and other activities that may not be a part of such banks' activities. This is, however, no different than the situation faced by a registered broker-dealer that engages in a purely retail business, and there is no apparent reason for distinguishing between the examinations required for supervisors in banks and the examinations required for supervisors in retail broker-dealers.

In this regard, the role of the supervisor in a registered broker-dealer firm is critical to the compliance policies and procedures of that firm. Without a strong supervisory system, no level of training and testing can prevent compliance violations. ⁴ The critical role of supervision in securities firms' compliance programs is reflected in Sections 15(b)(4)(E) and 15(b)(6) of the Securities Exchange Act of 1934, which expressly authorize the SEC to sanction registered broker-dealers, and supervisors of registered broker-dealers, for failing to reasonably supervise the activities of others. Moreover, the SEC, and the NASD and other SSROs, have been placing increasing emphasis -- both in the inspection and enforcement arenas -- on the supervisory function. ⁵

As a result, as part of the banking agencies' efforts to assure that bank securities personnel are subject to training requirements that are equivalent to those applicable to the personnel of registered broker-dealers, SIA believes that supervisors of bank securities sales persons should be required to take and pass the same examinations as supervisors in registered broker-dealers. If, after appropriate experience with the NASD-administered examinations, the banking agencies determine that portions of those examinations are inappropriate for bank securities supervisors, it might then be appropriate for the banking agencies and the NASD to work together to develop a more targeted examination.

Second, the banking agencies should attempt to arrange for the NASD to become the self-regulator of banks that engage in securities activities, just as it is the self-regulator for the remainder of the securities industry. There is no legitimate reason why banks that engage in securities activities should be exempt from the self-regulatory scheme that every other member of the securities industry is subject to. Even if bank regulators enforced the securities laws precisely the same way and to precisely the same extent as does the SEC, banks that engage in securities activities still should be required to meet the higher investor protection standards that are required by the NASD. Also, as a competitive matter, banks that engage in securities activities also should be required to bear their portion of the costs of industry self-regulation that every other member of the securities industry bears.

Third, the banking agencies should attempt to arrange for SEC inspectors to examine banks that engage in securities activities (either with bank examiners or separately), to assure that the regulatory and enforcement priorities of the SEC are adequately represented in the bank examination program, and to help assure that all entities in the United States that sell securities are subject to similar oversight. For the reasons discussed earlier in this letter, bank examiners and bank regulatory agencies do not and cannot have the same priorities, the same focus, or the same experience as do SEC examiners. As a result, the current system of "separate but equal" securities regulatory regimes -- one for banks and one for the rest of the securities industry -- is inherently harmful to investors, and the two regulatory regimes are inherently

unequal, which creates unfair competitive disparities. This differential regulation could be significantly reduced if SEC inspectors examined banks that engage in securities activities. In addition, as discussed above, SIA believes that these SEC examinations could be coordinated with the examinations of the banking agencies so as to significantly minimize any unnecessary disruptive effect they may have on the banks.

Fourth, bank customers should receive disclosures of the significant differences in regulation of bank sales of securities and sales of securities by registered broker-dealers. For example, banks should be required to disclose to customers (such as in account opening documents): That the SEC and the NASD do not regulate sales of securities by banks, and the rules and regulations of the SEC and the NASD do not apply to such sales. Despite the fact that bank securities representatives must take the examinations administered by the NASD, the NASD has not endorsed or otherwise approved their securities activities. Whether a customer's securities account is subject to SIPC protection.

V. CONCLUSION

SIA supports the proposals in the Joint Notice, in order to advance the protection of investors who buy and sell securities through banks. SIA also supports requiring supervisors of bank securities representatives to take and pass the appropriate supervisory examination, as well as the other suggestions made in this letter. Ultimately, however, the proposals starkly demonstrate the need for functional regulation of bank securities activities. SIA will continue working with the Administration, Congress, the banking regulators, and the financial services industry to achieve this result in the context of financial services modernization legislation.

Please feel free to call Steve Judge, at (202) 296-9410, with any questions or comments, or if we can provide additional information.

Very truly yours,

Marc E. Lackritz

Footnotes

1 The Securities Industry Association brings together the shared interests of more than 760 securities firms throughout North America to accomplish common goals. SIA members -- including investment banks, broker-dealers, specialists, and mutual fund companies -- are active in all markets and in all phases of corporate and public finance. In the U.S., SIA members collectively account for approximately 90 percent, or \$100 billion, of securities firms' revenues and employ about 350,000 individuals. They manage the accounts of more than 50 million investors directly and tens of millions of investors indirectly through corporate, thrift and pension plans.

2 Under the proposals, bank securities representatives would not be subject to the NASD rules and regulations that govern the sales and many other practices of registered representatives of securities firms. Similarly, bank securities activities would remain subject solely to regulation by, and the inspection and enforcement oversight of, the banking agencies, while every other

securities firm in the United States would be subject to regulation, inspection and enforcement action by the SEC, the NASD and other securities self-regulatory organizations.

3 These unfair competitive advantages include the more obvious examples, such as potentially less vigorous regulation of bank securities activities than of the activities of registered broker-dealers. These unfair competitive advantages also include some less obvious examples, such as the ability of a bank to use proprietary information about a customer (particularly a customer that is a corporation or other entity) learned during the course of the banking relationship when seeking that customer's securities business as well.

4 In addition, there is a realistic concern that, absent appropriate supervision, brokers with disciplinary violations will be able to migrate to banks with securities programs. While testing supervisors will not by itself eliminate this problem, appropriate testing of supervisors is an important element of a comprehensive supervisory structure designed to prevent these and similar problems.

5 We are not aware that the banking agencies have placed the same emphasis on the role of the supervisor in preventing securities law compliance violations.