



**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>

July 17, 2001

By Hand and Via Electronic Mail

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

Re: Interim Final Rules for Banks Under Sections 3(a)(4) and  
3(a)(5) of the Securities and Exchange Act of 1934, Release No.  
34-44291, File No. S7-12-01

Dear Mr. Katz:

The Bank Retail Broker-Dealer Committee of the Securities Industry Association<sup>1</sup> appreciates the opportunity to comment on the interim final rules on the broker-dealer exceptions for banks, which implement Title II of the Gramm-Leach-Bliley Act ("GLB"), Pub. L. No. 106-102. The Bank Retail Broker-Dealer Committee is comprised of SIA broker-dealer firms that are affiliated with banks.

Our comments are focused principally on the limitations and restrictions the interim final rules place on referral fees under the GLB's third party brokerage exception. While there are issues raised by the interim rules that we wish to address, SIA appreciates the effort and hard work the Commission and its staff have put into the rules.

Title II of GLB is of utmost significance to our bank affiliates and the banking industry because it provides, by amending the Securities and Exchange Act of 1934 (the "Exchange Act"), what securities activities banks may continue to conduct as an

---

<sup>1</sup> The Securities Industry Association brings together the shared interests of nearly 700 securities firms to accomplish common goals. SIA member-firms (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. The U.S. securities industry manages the accounts of nearly 80-million investors directly and indirectly through corporate, thrift, and pension plans. In the year 2000, the industry generated \$314 billion of revenue directly in the U.S. economy and an additional \$110 billion overseas. Securities firms employ approximately 770,000 individuals in the U.S. (More information about SIA is available on its home page: <http://www.sia.com>.)

exception to the broker-dealer definitions of the Exchange Act. Although the interim rules have raised serious issues for many of our bank affiliates and the banking industry in general, our concerns are much more limited because the rules primarily impact our firms through the third party brokerage exception. Title II and the rules indirectly affect our firms in that activities determined to be no longer permissible within a bank have been or will likely be moved to the affiliated broker-dealer. For this reason, we have been coordinating with our bank counterparts to bring our institutions in compliance with GLB.

- **Third Party Brokerage Arrangements Pre-Date GLB**

Our firms have been conducting third party brokerage (or networking) arrangements with banks for several years, as provided in several no-action letters of the Commission. Up until GLB, these arrangements had been conducted pursuant to the SEC's no-action letter in Chubb Securities Corp., 1993 SEC No-Act. WL 5565540 (Nov. 24, 1993), Rule 2350 of the National Association of Securities Dealers and the Interagency Statement on Retail Sales of Nondeposit Investment Products, issued by the Board of Governors of the Federal Reserve, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision. These networking arrangements have permitted consumers to have access to a wide range of financial products and services all in one place. The payment of referral fees to bank personnel who refer customers to the registered representatives of broker-dealers has been a fundamental part of these arrangements.

The GLB third party brokerage exception was modeled on the prior networking arrangements and was intended to keep the same practices in place.<sup>2</sup> The GLB Act permits, as an exception from the definition of broker, banks to enter into third-party brokerage or networking arrangements with registered broker-dealers to offer brokerage services to bank customers. Under the GLB exception, bank employees (other than dual employees of the bank and broker-dealer) are prohibited from receiving "incentive compensation," except that a bank employee may receive compensation for the referral of any customer "if the compensation is a nominal one-time cash fee of a fixed dollar amount and the payment of the fee is not contingent on whether the referral results in a transaction."<sup>3</sup>

- **Rules Place Unnecessary Limitations on "Nominal" Referral Fees**

In the interim rules, the Commission has now defined "nominal one-time cash fee" to include restrictions that are beyond the language and intent of GLB, and inconsistent with industry practice. The interim rules provide that the term "nominal one-time cash fee of a fixed dollar amount" is to be limited to only: (1) "[a] payment that does not exceed one hour of the gross cash wages of the unregistered bank employee making a referral;" or (2) "[p]oints in a system or program that covers a range of bank

---

<sup>2</sup> S. 900, Conference Report, Statement of Managers, Title II (November 1, 1999).

<sup>3</sup> 15 U.S.C. § 78c(a)(4)(B)(i)(VI).

products and non-securities related services where the points count toward a bonus that is cash or non-cash if the points (and their value) awarded for referrals involving securities are not greater than the points (and their value) awarded for activities not involving securities.”<sup>4</sup>

Based upon the language of GLB and the industry’s long experience with networking arrangements, we do not see the justification for additional limitations on the form of payment “nominal fees” may take. As the SEC’s adopting release acknowledges, GLB and its legislative history indicate that Congress intended the networking exception to codify the existing framework that has governed these arrangements.<sup>5</sup> The “nominal fee” standard for referral fees is contained in NASD Rule 2350 and the Interagency Statement, and the industry’s practice of payment of nominal fees has been subject to NASD and bank regulation. Moreover, prior to the interim final rules, the Commission has never sought to define “nominal fee.” The Commission’s no-action letters involving networking arrangements merely state that the registration requirements of the Exchange Act are not triggered by networking arrangements in which a bank employee receives a “nominal fee” for referrals to the registered broker-dealer.<sup>6</sup>

While we recognize that the SEC was trying to create a flexible approach, the rules’ limitations on nominal fees through monetary payments or in the form of award points are unworkable and detrimental to the overall securities referral programs between broker-dealers and their affiliated or networked banks. Using the hourly rate of bank personnel as the standard for “nominal cash payment” will not be effective in creating the proper framework to foster appropriate referrals. An employee’s hourly rate has no relationship to the value of a securities referral and, in practice, many of our affiliated banks have compensated all or many of their employees, regardless of the level of their compensation, the same nominal award for referring securities customers. Requiring the payment of a greater fee to an employee simply because his hourly wage is higher is not required by GLB and does not further the protection of investors. A bank using this scale would be forced to apply the lowest possible hourly rate across the board. But in doing so, the Commission’s proposed standard loses the very flexibility that the Commission tried to inject, while also creating an unprecedented and substantially changed definition of nominal.

For our member firms and their affiliated banks, referral fees based on an hourly wage will create an administrative nightmare because a separate referral fee calculation will now be required for each employee who makes a referral. Referral fee programs will have to be adjusted each time an employee’s salary changes – which typically happens annually, but often more frequently because of employee position changes and promotions. Using the hourly wage also raises privacy concerns in that employees’ hourly wage and thus compensation would be made known to many throughout the bank

---

<sup>4</sup> Interim Rule § 240.3b-17(g)(1).

<sup>5</sup> See Adopting release at 27765, n.38.

<sup>6</sup> See, e.g., Chubb Securities Corp., 1993 SEC No-Act. WL 565540 (Nov. 24, 1993).

and broker-dealer (who otherwise would not be privy to such information) in order to implement the incentive program.

Although we appreciate the effort of the Commission to clarify that payment of referral fees may be in the form of points, the interim rules' provision concerning points is problematic and runs counter to the successful practice of the industry. The interim rules require that the points for securities referrals be "not greater than the points . . . awarded for activities not involving securities."<sup>7</sup> The point system for referral payments required by the rules means that points for a securities related referral can be no greater than the points for the referral for any other product or service – irrespective of the nature or value of the other product or service. Thus, the points awarded for a securities referral are reduced to the lowest amount given for any other product. For example, a securities referral would be treated the same as a safe-deposit box opening or other basic item.

We see no requirement in GLB that the points awarded for securities referrals be no more than the award for the referral of any other product. Moreover, the inherent problem with the interim rules is that in order for referral systems to be effective they must recognize that not all products are alike and that some activities are more valuable than others. The referral for opening a safe deposit box should not justify the same award as the referral of a customer who opens an account with \$50,000 in investment assets. On the other hand, we recognize that there should be no differences between insured product sales and investment product referrals, i.e., that the points awarded for securities referrals should be no greater than the points awarded for "comparable" products or services not involving securities.

The rules also provide that securities referral fees – whether points or cash – may not be related to: (1) size or value of any securities transaction; (2) amount of securities-related assets gathered; (3) size or value of a customer's bank or securities account; or (4) financial status of a customer.<sup>8</sup> We think these are unnecessary limitations that do not serve the best interest of investors. GLB's safeguard – the prohibition of the payment of a referral fee that is contingent on whether the referral results in a transaction – is sufficient to protect investors.

GLB's mandate is satisfied if the "nominal fee" standard alone for referral fees is maintained. No further limitations on either monetary payments or award points is necessary. Indeed, Congress adopted "nominal fee" in GLB because it was recognized and used by the bank regulatory agencies, the NASD and the SEC. The Commission should allow, as under current practice, banks and broker-dealers to interpret the term in a manner that best fits their networking arrangements. This standard gives flexibility to firms and can be monitored through the regulatory process.

- **Rules' Restrictions On Bonus Programs Could Be Applied Too Broadly**

---

<sup>7</sup> Interim Rule § 240.3b-17(g)(1)(ii).

<sup>8</sup> Interim Rule § 240.3b-17(g)(2).

We request that the Commission clarify the rules' treatment of bonus programs. While the rules provide that referral fees cannot be paid in the form of bonuses, the language employed could be read to apply to bonus programs and employees throughout a financial institution that have no direct participation in a third party brokerage arrangement. The adopting release states that "[t]o rely on the third-party exception . . . banks cannot indirectly pay their unregistered bank employees incentive compensation for securities transactions through . . . a bonus program related to the securities transactions of a branch, department, or line of business." This provision could be interpreted to prevent an institution or its bank with a networking arrangement from paying any officer -- such as a senior executive of the financial institution in charge of the asset management area (which includes the broker-dealer) -- a bonus based on the success of a department or line of business that engages in licensed securities activities, even where there is no connection with the networking arrangement. Accordingly, we ask that the Commission clarify that the interim rule does not apply to financial institution bonus programs generally.

We also question the need to prohibit the payment of referral fees through bonus or incentive payments. Prior to GLB, the Commission dealt with bonus programs in connection with referral programs by addressing the potential for double counting referrals, which could run afoul of the "one-time" fee requirement. In Chubb, the Commission said:

"Unregistered persons will be paid no more than one fee per customer referred. Other than this one-time, nominal fee, unregistered employees will not receive any other compensation, such as trips, free meals, or monetary awards, as the result of a referral or the number of referrals made. Supervisory employees will not receive any fees for referrals made by their subordinates."<sup>9</sup>

This appropriate limitation kept each referral from counting twice. Together with the ban on transaction-based compensation, these standards have long met the needs of customer protection without unnecessarily restricting bonus programs for bank employees. In fact, bonus payments may prove a viable alternative to compensate for referrals while limiting any potential salesman's stake, as the payments are made at year-end and not directly tied to each referral.

The Commission has asked for comment on whether the rules should include gross compensation standards to prevent a bank from paying referral fees that constitute a substantial portion of an employee's total compensation. Such limitations have no basis in GLB and are unnecessary in light of the industry's experience with networking arrangements and referral fees. Requiring that each referral fee is nominal is sufficient to satisfy the requirements of GLB, limit the salesman's stake, and protect investors.

- **Clarity For Trust and Fiduciary Accounts Pushed Out To Broker-Dealers**

---

<sup>9</sup> Chubb, 1993 WL 565540 at 8.

We also do not think that it is clear from the rules how broker-dealers are expected to handle transactions or accounts that do not satisfy the Trust and Fiduciary Exception and are thus pushed out from the bank and into the broker-dealer. It is our understanding from conversations with the SEC staff that for transactions or accounts that are pushed out, without further undertaking, the broker-dealer's obligation is to execute the trade on an unsolicited basis. In such case, we conclude that the broker-dealer has no obligation to advise, exercise discretion or act as a trustee for any account or transaction pushed out from the bank. We request that the Commission confirm this understanding and urge the SEC staff to continue to seek industry input to insure the rules accommodate all of the operational issues raised when a bank's accounts or transactions are pushed into a broker-dealer.

---

In sum, we are concerned that the interim rule's referral fee provisions defeat the balances carefully struck by GLB, and establishes a system that is not in the best interest of satisfying the securities needs of bank customers. The statute set parameters to permit active brokerage business on bank premises, but ensure that registered representatives remain responsible for ensuring that any securities transaction is consistent with the investor protection requirements of the securities laws. The industry's successful participation in networking arrangements, as recognized by GLB, should be used as the regulatory model.

Lastly, in recognition of the historic changes brought about by GLB, we request that the SEC delay mandatory compliance with Title II until a sufficient time after the rules are in final form to allow the industry to make the necessary changes to their systems. In particular, our firms will require additional time because they will only be able to finalize their systems after their affiliated banks have determined what activities the final rules require to be shifted into broker-dealers.

If we can provide any further information, please contact Alan E. Sorcher at (202) 296-9410.

Sincerely,

Barry P. Harris  
Chair  
Bank Retail Broker-Dealer  
Committee