Securities Industry Association
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September 1, 2004

Via Electronic Mail

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

Re: Proposed Regulation B under Section 3(a)(4) of the Securities Exchange Act of 1934, as amended, Release No. 34-49879; File No. S7-26-04.

Dear Mr. Katz:

The Bank Holding Company Committee of the Securities Industry Association ("SIA") [1] appreciates the opportunity to comment on proposed Regulation B under Section 3(a)(4) of the Securities Exchange Act of 1934, as amended ("1934 Act"). The Bank Holding Company Committee is comprised of SIA broker-dealer firms that are affiliated with banks. While proposed Regulation B raises several issues that we wish to address in this letter, SIA would like to commend the Securities and Exchange Commission ("Commission" or "SEC") and its staff on the effort and hard work that they have put into these rules.

Our comments are focused on the limitations and restrictions that proposed Regulation B would place on referral fees and bonus systems under the third-party brokerage exception (or "networking exception"). In particular, we address: 1) the need for a more flexible approach to the definition of "nominal fee;" and 2) the need to be able to condition the payment or amount of a referral fee on criteria relating to other aspects of a customer's financial profile.

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[1] The Securities Industry Association, established in 1972 through the merger of the Association of Stock Exchange Firms and the Investment Banker's Association, brings together the shared interests of nearly 600 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. According to the Bureau of Labor Statistics, the U.S. securities industry employs 790,600 individuals. Industry personnel manage the accounts of nearly 93-million investors directly and indirectly through corporate, thrift, and pension plans. In 2003, the industry generated $213 billion in domestic revenue and an estimated $283 billion in global revenues. (More information about SIA is available on its home page: www.sia.com.)

Networking Arrangements Benefit Customers

SIA believes that networking arrangements between broker-dealers and banks are beneficial to the financial institutions and to their customers. The SEC rules should, to the extent feasible, facilitate the implementation, and provide the flexibility for the development and evolution of these arrangements. Among other things, networking arrangements facilitate the diversification of a customer's financial portfolio and provide the customer access to menus of financial products that no single broker-dealer or bank could typically offer. This opportunity for diversification is accompanied by the opportunity for professional advice from both bank and broker-dealer personnel and is subject to regulatory oversight by both the banking and securities regulators.

Networking arrangements also benefit broker-dealers and banks by permitting banks to provide access to a more complete range of financial products and services than they otherwise could, and to better serve the financial needs of their customers. Networking arrangements may also permit smaller financial institutions to provide their customers access to financial alternatives that otherwise would be available only through larger, more diversified firms.

SIA also believes that Congress, the SEC and the federal banking regulators all have implicitly recognized the value of fostering networking relationships, as evidenced by the inclusion of the bank exception for networking arrangements in the Gramm-Leach-Bliley Act ("GLB" or "Act"), the SEC staff's decision to permit networking arrangements in a series of no-action letters, and the efforts of the financial regulators to set forth a workable framework for these activities in the Inter-Agency Guidelines.[2]

As a result, SIA believes that the Commission should, to the extent possible, avoid imposing additional requirements on networking arrangements beyond those required under the plain language of the Act. To that end, the rules implementing GLB should not impose restrictions beyond those deemed necessary or desirable by Congress in the Act. SIA submits that the SEC's rules governing networking arrangements should build on the significant prior body of experience with such arrangements, and the dual regulatory oversight over such arrangements by both securities and banking regulators, and seek to make the regulation of those arrangements more flexible than they had previously been. Although the proposed rules are, in general, an improvement over the initial proposals, it unfortunately appears that in several respects the proposed rules would impose new – and in our view needless – restrictions on networking arrangements.

While SIA appreciates and shares the SEC's goal – the protection of the investing public – we respectfully submit that in some areas the proposed rules go beyond what is

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[2] Federal Reserve, FDIC, OCC, and OTS, *Interagency Statement on Retail Sales of Nondeposit Investment Products* (Feb. 15, 1994).

necessary for, or reasonable in, achieving that goal, and beyond what Congress intended through GLB.

Need For a More Flexible Definition of "Nominal Fee"

SIA believes that the proposed definition of the term "nominal one-time cash fee of a fixed dollar amount" is one such case: the proposed definition is narrower than required by GLB and goes further than necessary to protect investors from the abuses that broker-dealer registration was intended to address. Under proposed Regulation B, a nominal fee is one that does not exceed the greater of: (a) the employee's base hourly pay; (b) $25 dollars; or (c) $15 in 1999 dollars adjusted for inflation. SIA believes that this definition, if adopted, would require a number of banks to significantly modify their current networking arrangements and incentive plans in several respects that will not benefit these arrangements or their customers. Furthermore, the new requirements will not meaningfully increase the protection of investors, nor further the goals and objectives of GLB.

SIA believes that the proposed definition of a "nominal one-time cash fee of a fixed dollar amount" would significantly interfere with a variety of bonus, incentive and similar programs currently offered to bank employees in connection with networking arrangements. In many of these programs, an employee may receive "points" for a securities referral pursuant to a networking arrangement (as well as for non-securities related activities), and the total points accumulated by that employee over a quarter, year or other period will determine that employee's level of participation in a bonus pool or incentive program. However, at the time the employee receives points for a referral, the value of his or her participation in that bonus pool or incentive program may not be a known (or "fixed") dollar amount, either because the value of a "unit" in the pool or program is not yet determined, or because the employee's level of participation in that pool or program will depend upon the total number of points accumulated by that employee (e.g., 100 points entitles an employee to one level of participation, and 125 points entitles that employee to another level of participation).

There is nothing inherent in such an arrangement that would give a bank employee any more of a "salesman's stake" in the networking arrangement than fee arrangements expressly permitted under proposed Regulation B, so long as each securities referral fee paid to the employee will always be "nominal."

In this regard, SIA believes that the GLB networking exception does not require the value of the "nominal one-time cash fee of a fixed dollar amount" to be measured as of the date the fee is paid.[3] Instead, we propose a more flexible approach that would

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[3] Proposed Rule 710(b)(3)(i) would require any portion of a referral fee paid other than in cash to be "paid in units of value with a readily ascertainable cash equivalent." Here again, there is no reason why the value of the units needs to be determinable at the time the units are awarded, as long as at the time they are

allow the precise value of that referral fee to be measured as of the end of the quarter, year or some other specified period while still requiring each securities referral fee paid to a bank employee to be "nominal" when the referral is made. Under this flexible approach, while banks and bank employees may not know the precise value of a referral fee when the referral is made, they will know that it will not exceed the "nominal" standard as defined in the proposed rule. This approach is entirely consistent with the Commission's position that a referral fee not provide a bank employee with a "salesman's stake" in a securities transaction (because a referral fee paid under this approach will always be nominal) but, at the same time, it allows banks to continue to offer bonus programs that feature different bonus payments based on the level of points achieved.[4]

In addition, several other aspects of the definition of "nominal one-time cash fee of a fixed-dollar amount" in proposed Regulation B appear not to have a reasonable basis in the language of GLB or in the purposes sought to be achieved by the 1934 Act. For example, under the proposed definition, all or a portion of a referral fee could be paid other than in cash only if, among other things, the payment is made "under an incentive program that covers a broad range of products and that is designed primarily to reward activities unrelated to securities."

If an incentive program otherwise meets the requirements of the GLB networking exception and proposed Regulation B, there appears to be no reason to require the program to primarily reward non-securities related activities. Under the networking exception, a bank is permitted to pay an employee a cash referral fee for a referral that is completely securities related. The requirement that an incentive program in which the employee receives points or both points and cash needs to be broadly inclusive and designed to primarily reward non-securities activities is an unnecessary limitation. Rather, the focus should again be on whether the points and other remuneration received by the bank employee for a broker referral under the incentive program is "nominal," regardless of what portion of the program relates to securities referrals.

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converted into an interest in a bonus, incentive or similar plan, they have a readily ascertainable cash equivalent, and the value of each unit awarded for a broker referral is nominal.

[4] Arguably, this position finds some support in the Commission's statement in the proposing release that "consistent with the meaning [the SEC] propose[s] to give "cash fee" in the definition of a "nominal one-time cash fee of a fixed dollar amount," a referral fee could be paid partially in cash at the time of the referral and partially in points to be paid to the employee as a bonus at a later time, if the total value of cash and points in which the fee is paid has a nominal value under the definition." This statement could be read to suggest that the amount of a referral fee need not be known to the bank and bank employee at the time of the referral as the proposed rule otherwise requires, but rather, once the bonus portion of that fee was paid at a later time, the referral fee's total value must be nominal. This approach would be more akin to what we have proposed above. However, we understand that staff may disagree with this interpretation of the statement and such an approach. Nonetheless, we believe that the staff should adopt a final rule that does not require banks and bank employees to know the precise value of a referral fee at the time the referral is made so long as the referral fee will never be more than "nominal."

While we recognize that the SEC was trying to create a more flexible approach to the definition of "nominal," referral fees based on employee's base hourly pay will create considerable administrative burdens for member firms and their affiliated banks. This standard will require member firms to establish processes and systems that calculate a referral fee limit for every employee and that would track and adjust for an increase in salary of each employee. The administrative burdens of such a system may negate the utility of such an approach.

SIA also believes that the $25 limit in the Proposed Rule is also more restrictive than that intended by GLB and not necessary to protect the investing public. We believe Congress chose the term "nominal" – which is a relative term – in recognition of past industry practice and the flexibility that term allowed. The Proposed Rule recognizes this by including an employee's hourly wage as one measure of nominal. For example, a $25 referral fee may be nominal for some bank employees, but inconsequential to a much higher paid employee. Thus, the Proposed Rule's limitations on nominal fees may prove detrimental to the overall securities referral programs between broker-dealers and their affiliated or networked banks. Accordingly, SIA recommends that the dollar cap on referral fees be greater $25.

We also request that the Commission confirm that the Proposed Rule does not prohibit the payment of a fee for a brokerage referral within an incentive or bonus plan that incorporates employee goals or thresholds. As discussed earlier, points-based plans within the banking industry typically require that an employee meet pre-determined point thresholds before any incentive compensation is awarded. Accordingly, a bank employee could make a brokerage referral and receive credit for the designated points under the plan, but ultimately receive no incentive compensation for the referral because the plan threshold was not met. Therefore, we request the Commission confirm our understanding that the Proposed Rule does not prohibit plans that incorporate thresholds or goals.

Referral Fees Should Be Able to Be Made Contingent on Additional Criteria

The Act provides that a fee received by a bank employee in connection with a networking arrangement may not be "contingent on whether the referral results in a transaction." This is wholly consistent with the Commission's long-standing view that the receipt of transaction-based compensation – i.e., compensation that is contingent on the completion of a securities transaction – is a hallmark of what constitutes a broker-dealer. However, proposed Regulation B goes far beyond the plain language of GLB, and far beyond the theoretical underpinnings of that language, and permits a networking fee to be subject to only two types of contingencies: whether a customer contacts or keeps an appointment with the broker-dealer, and whether the customer meets a generally applicable minimum asset, net worth or similar financial standard.

Accordingly, proposed Regulation B would not permit the amount of a referral fee to vary based on factors such as the different financial status of different customers,

even though nothing in GLB requires such a result, and even though the payment of a referral fee that varies based on the financial status of a customer (regardless of whether a securities transaction was ever executed) typically would not require broker-dealer registration in any other context. This type of restriction makes little practical or theoretical sense. A bank employee who receives greater, but still nominal, compensation for referring a wealthy customer than for referring a customer of more modest means has no salesman's stake in either referral, as long as that nominal compensation is not tied to the completion of a transaction.

Permitting such financial distinctions arguably ought to be encouraged, since the federal securities laws often use wealth as a proxy for financial sophistication, and there seems to be a sound regulatory objective in permitting networking arrangements that more strongly encourage brokerage referrals of financially sophisticated bank customers than referrals of less sophisticated bank customers. In any event, as long as the compensation paid to the bank employee is "nominal" regardless of the financial status of the referred customer, the fact that the compensation varies with the financial status of that customer ought not to give rise to any of the concerns that broker-dealer regulation was intended to prevent.

In summary, SIA is concerned that several of the limitations and restrictions that proposed Regulation B would place on referral fees and bonus and incentive plans under the networking exception are not consistent with GLB and the purposes of the 1934 Act, and would needlessly interfere with the benefits that customers and financial institutions can receive from networking arrangements.

If we can answer any questions or provide any further information, please contact the undersigned at (202) 216-2000.

Sincerely,

Alan E. Sorcher
Vice President and
Associate General Counsel