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Department of the Treasury
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James E. Gilleran
Director

September 1, 2004

Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-0609

Re: File Number S7-26-04

Dear Mr. Katz:

We appreciate the opportunity to comment on the Securities and Exchange Commission's (SEC's) proposed Regulation B.[1] Proposed Regulation B establishes rules codifying a number of the statutory exceptions from the definition of "broker" contained in the Gramm, Leach, Bliley Act (GLBA). In addition, proposed Regulation B creates new exemptions from the "broker" definition for banks but limits this exemptive relief for other financial institutions. The Regulation B proposal does not give savings associations all of the newly created exemptions that banks have received. We strongly object to this inequitable treatment. Any final rule on proposed Regulation B should create parity between savings associations and commercial banks.

Under proposed Regulation B, savings associations will not receive the general custody exemption in Exchange Act Rule 760, the new ERISA exemption in Exchange Act Rule 770 or the Regulation S exemption in Exchange Act Rule 771 (the three exemptions). According to the preamble, the reason that these three exemptions were not extended to savings associations is that the SEC was unable to obtain sufficient information to determine whether savings associations directly engage in the types of securities activities covered by the three exemptions. We strongly disagree with the conclusion reached in the preamble that savings associations do not engage in the type of securities activities covered by the three exemptions. OTS regulated savings associations are engaging in these activities and have been for quite some time.

In addition to our concern that the SEC does not fully appreciate the extent to which savings associations engage in the activities covered by the three exemptions, we want to make sure that savings associations are treated in a similar manner to banks. According to the preamble, the specially created exemptions were designed to supplement the statutory exceptions and preserve bank securities activities where consistent with the statutory purpose of investor protection. The SEC determined bank securities activities by talking with selected banks willing to meet and

[1] 60 Fed. Reg. 39682 (June 30, 2004)

discuss these matters with the SEC on an informal basis. The SEC staff then created the specially created exemptions and applied them to all banks. By doing so, every bank across the country will receive the benefit of the exemptions even though every bank may not be currently engaging in the securities activities covered by the specially created exemptions.

We are aware that since the release of the Regulation B proposal, the SEC has had the benefit of receiving information directly from savings associations. We surmise that with information gained from those discussions, coupled with the information provided herein, the SEC now has a sound basis for extending the three exemptions to savings associations. Further, as is the case with banks, we assume that the exemptions will be made available to all savings associations, without regard to whether they are currently engaged in the securities activities covered by the three exemptions. We are concerned that other approaches, such as the issuance of individual no-action letters for savings associations engaging in securities activities covered by the three exemptions, would put the savings association charter at a disadvantage to that of a bank charter.

Safekeeping and Custody

A. Activities that are permitted under the statutory exception

Proposed Regulation B states the view of the Commission that the GLBA safekeeping and custody exception permits a bank to, among other things, exercise warrants or other rights, facilitate the transfer of funds or securities in connection with clearing and settling customers' securities transactions, effect securities lending or borrowing transactions and invest cash collateral pledged in connection with such transactions, and hold securities pledged by a customer or facilitate the pledging or transfer of securities that involve the sale of those securities. In addition, the exception expressly permits a bank to "serve as a custodian or provider of other related administrative services" to IRAs, pension, retirement, profit sharing, bonus, thrift savings, incentive, or other similar benefit plans without being considered a broker. Under Rule 773, savings associations would also be permitted to engage in these activities without registering as a broker, as proposed Regulation B extends all statutory bank exceptions from the definitions of broker and dealer to savings associations or savings banks on the same terms and conditions as banks.

B. Order-taking

The Regulation B proposal perpetuates the mistaken assumption contained in the Interim Final Rules that the safekeeping and custody exception does not permit banks to accept their customers' orders to purchase or sell securities. This assertion is contrary to the statute and legislative history of the GLBA's exception for custody and safekeeping activities. Order-taking activities have been, and are today, part of customary banking activities. Savings association and bank custodians have a long-standing history of accommodating customers by accepting and transferring orders for securities to a registered broker-dealer. The GLBA included an exception for safekeeping and custody services to preserve the traditional role of banks in providing customary custodial services, which has always included order taking, for their customers. In enacting this exception, Congress expressed clear intent that traditional custodial, safekeeping and clearing activities, including custodial IRA relationships, remain within the bank.[2] Contrary to this statutory scheme and congressional intent, proposed Regulation B does not include customary custodial order-taking services within the exception.

C. Custody Exemptions in General

Proposed Regulation B provides several exemptions (general custody exemption and small bank custody exemption) that allow banks to accept orders from a custody account, subject to certain conditions. This is where savings associations and banks are treated differently despite the fact that both savings associations and banks are engaged in the same order-taking activities on behalf of their customers. According to the preamble, the stated reason for not extending the general custody exemption to savings associations is that the SEC was unable to obtain sufficient information to determine whether savings associations directly engage in the types of securities activities covered by the exemption.

Savings associations file detailed financial information, called a "Thrift Financial Report" (TFR) with us on a quarterly basis. The TFR is very similar to the "Call Report" that banks file on a quarterly basis with their appropriate regulator. By examining the TFR reports of March and June 2004, we have determined that approximately 65 savings associations with trust powers conduct safekeeping and custody activities. This represents approximately 10 million account relationships holding $377 billion in assets. We do not have statistical information regarding the safekeeping and custody activities of savings associations that do not have trust powers, as there is no line item on the TFR that relates to those activities outside of a trust department environment. The safekeeping and custody activities of the 65 savings associations that engage in these activities consist of asset custody, security transaction processing, security trade settlement, account recordkeeping, processing receipts and disbursements, and various customer and regulatory reporting. Our experiences with these institutions through the examination and monitoring processes allow us to conclude that savings associations do, in fact, engage in a significant amount of order-taking activities.

We strongly urge the Commission to extend the general custody exemption to savings associations for two reasons. The first is that savings associations are engaged in order-taking in the same manner as banks. The second is that many savings associations will not be able to take advantage of the small bank custody exemption due to the conditions placed on size and holding company affiliation. Without the benefit of either exemption, savings associations will not be able to continue to provide an activity that is requested by their customer base.

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[2] The Senate Report states "the Committee believes that bank custodial, safekeeping and clearing activities with respect to IRAs do not need to be pushed-out into a Commission registered broker-dealer." S. Rep. No. 106-44, at 10 (1999).

We also urge the Commission to provide savings associations the same 30-day grandfather period for existing customers that has been extended to banks. Under current Rule 760, banks may accept orders to effect transactions in securities in an account for which the bank acts as a custodian for a person with an account that was opened before July 30, 2004.

D. Small Bank Custody Exemption

The Regulation B proposal provides a limited exemption from the definition of ‘broker” under Exchange Act Section 3(a)(4) to permit small banks (and savings associations) to receive transaction-based compensation for effecting transactions in investment company securities held in tax-deferred custodial securities accounts, such as custodial IRAs. The exemption is only available to banks (and savings associations) with less than $500 million in assets that are not affiliated with a bank holding company or a savings and loan holding company that, as of December 31 of both of the two prior calendar years, had consolidated assets of more than $1 billion. There are several other conditions that must be met but these restrictions are the two that have the most impact on savings associations.

We currently regulate 902 savings associations. Of those, approximately 719 have less than $500 million in assets. There are also approximately 498 OTS regulated holding company enterprises. The major business classes of these holding company enterprises are extremely diverse. They range from the typical financial and insurance industry holding companies to those whose major business class is manufacturing, real estate, agriculture, utilities or retail trades. Of the holding company enterprises that we regulate, approximately 129 have consolidated assets of more than $1 billion.

There is no reason given in the preamble for the bank holding company and savings and loan holding company $1 billion restriction. There are more than adequate restrictions contained in Rule 761 that limit the way savings associations and banks may solicit orders, compensate their employees for the sale of securities, and limit their annual sales compensation to make this additional restriction appear unnecessary. Additionally, the restrictions regarding the holding company affiliation would not impact the order-taking activities of savings associations or banks; particularly since the range of activities that holding companies engage in is exceptionally broad. We strongly urge the Commission to remove the holding company affiliation restrictions in the small bank custody exemption.

ERISA Exemption

The Commission has proposed to exempt bank trustees and non-fiduciary administrators that effect transactions in securities of open-end companies for participants in employee benefit plans from the definition of broker. The Commission has not extended this exemption to savings associations. Again, according to the preamble, the stated reason for the failure to extend the ERISA exemption to savings associations is that the SEC was unable to obtain sufficient information to determine whether savings associations directly engage in the types of securities activities covered by the exemption.

We strongly urge the Commission to extend the ERISA exemption to savings associations. Savings associations are engaged in the activities covered under the ERISA exemption in the same manner as banks. In fact, many of our savings associations were chartered specifically and only to provide administrative and other services to employee benefit plans. Without the benefit of the ERISA exemption, savings associations will be forced to utilize the trust and fiduciary exception, which will result in a drastic restructuring of their existing and future fee arrangements to meet the chiefly compensated test under that exception. Such a restructuring may put these institutions at a competitive disadvantage with their bank counterparts.

By examining the TFR reports of March and June 2004, we have determined that approximately 52 savings associations with trust powers conduct activities covered by the ERISA exemption. This represents more than one-half of the OTS supervised institutions authorized to exercise trust powers. The 52 institutions administer approximately 136,924 account relationships affected by the ERISA exemption and hold approximately $130 billion in assets in those accounts. The ERISA activities of the 52 savings associations basically mirror those of banks acting in the same employee benefit capacities. They include asset management, security transaction processing, security trade settlement, participant recordkeeping, processing receipts and disbursements, asset custody, proxy voting, and both plan participant and regulatory reporting.

Regulation S Exemption

The Commission established Rule 771, which would permit banks to sell securities that are covered by the safe harbor from U.S. registration pursuant to Regulation S, to offshore non-U.S. persons, both as agent and on a riskless principal basis. Under the exemption, a bank could resell any eligible Regulation S security after its initial issuance by, or on behalf of, a non-U.S. person or to a non-U.S. person as long as the bank continues to comply with the requirements of Regulation S. After the requirements of Regulation S cease to apply to an issuance, the bank could resell the securities to another non-U.S. person or a broker-dealer without meeting the terms of Regulation S. Savings associations were not extended this exemption.

Savings associations offer private banking services. Because we do not collect information pertaining to private banking activities on the quarterly TFR, we cannot provide aggregate industry data in this area. In addition to private banking activities, there are also savings associations that conduct offshore activities. Typically we become aware of these activities through the application process or notification requirements. If the activity is conducted in a subordinate entity such as an operating subsidiary or a service corporation, then the savings association must file an application with us before engaging in the activity. Part of the application materials submitted to us include a description of the activity as well as a discussion of the risks involved and the controls the association will utilize to manage the identified risks. If the savings association wishes to engage in offshore activities directly, they typically consult with their OTS regional office and again describe the activities and the controls that will be utilized to manage risk.

Since we are aware of a number of savings associations involved in private banking and offshore services, we believe that there are savings associations engaged in transactions described in the exemption. Therefore, we urge the Commission to extend the Rule 771 exemption to savings associations in the same manner as banks.

Trust and Fiduciary Activities Exception

Section 3(a)(4)(B)(ii) of the Security Exchange Act of 1934 permits a bank, under certain conditions, to effect transactions in a trustee or fiduciary capacity without registering as a broker. Under this exception, a bank must effect such transactions in its trust department, or other department that is regularly examined by bank examiners for compliance with fiduciary principles and standards. The bank also must be "chiefly compensated" for such transactions, consistent with fiduciary principles and standards, on the basis of: 1) an administration or annual fee, 2) a percentage of assets under management, 3) a flat or capped per order processing fee that does not exceed the cost the bank incurs in executing such securities transactions, or 4) any combination of such fees. Savings associations, through Rule 773, have been extended relief under this exception.

Although savings associations have been given relief under this exception, we have concerns with the "chiefly compensated" test. Past provisions relating to the chiefly compensated test have engendered a great deal of comment from the banking industry and from banking regulators. Although the Proposal does provide additional relief for savings associations and banks through the line of business and bank wide exemptions, savings associations and OTS join the banking industry in their concerns regarding the overall expense and operational difficulties that savings associations and banks will encounter in implementing the systems required to become compliant with the provisions of the chiefly compensated test.

Although we have many concerns regarding the chiefly compensated test, we'd like to discuss one area that seems to continually surface in conversations with savings associations that will need to implement systems to meet the proposed Regulation B requirements. The concern is that the grandfather exemption for existing living, testamentary, and charitable trust accounts is only available to those institutions that are utilizing the account by account method of calculating the chiefly compensated test.

The stated purpose of excluding the above referenced accounts from the account-by-account calculation is that banks need flexibility with respect to established personal trust accounts that have terms that cannot readily be changed without consequences to both the bank and the trust beneficiaries. Banks have explained to the SEC that fees received in connection with these accounts were negotiated in the past and may be difficult to change to meet the "chiefly compensated" condition due to, for example, the age or type of the trust. Savings associations and banks administer large numbers of trusts that were created by settlors who have since died or who may have become incompetent. State law may also make it difficult, if not impossible, to change the compensation structure of existing accounts. Given the above reasons, it would be logical that these accounts be excluded from both the line of business and bank wide exemptions.

Conclusion

In summary, the Regulation B proposal does not give savings associations all of the newly created exemptions that banks have received. Under proposed Regulation B, savings associations will not receive the general custody exemption in Exchange Act Rule 760, the proposed new ERISA exemption in Exchange Act Rule 770 or the proposed Regulation S exemption in Exchange Act Rule 771 (the three exemptions).

According to the preamble, the reason that these three exemptions were not extended to savings associations is that the SEC was unable to obtain sufficient information to determine whether savings associations directly engage in the types of securities activities covered by the three exemptions. This comment letter clarifies that OTS regulated savings associations are engaging in these activities and have been doing so for some time. We monitor the activities on an on-going basis through examination and off-site analyses. We request the SEC to extend any and all exemptions granted to banks to savings associations so that parity between the bank and savings association charter is maintained and savings associations are not forced to restructure their business because of the lack of comparable exemptions. If the SEC dos not intend to provide comparable exemptions to savings associations, we ask that the SEC provide us with the opportunity to appear before the full Commission to present our views on the Proposal prior to taking any action to finalize it in its current form.

Thank you for the opportunity to comment on the Proposal. We would be happy to discuss any aspect of these comments at your convenience.

Sincerely,

James E. Gilleran
Director

cc: Commissioner Cynthia A. Glassman

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