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By E-mail: rule-comments@sec.gov

Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 5th Street, NW
Washington, D.C. 20549-0609

Re: Proposed Rules for Banks Under Sections 3(a)(4) of the Securities Exchange Act of 1934 (the "Exchange Act"), Release No. 34-49879 (File No. S7-26-04): Regulation B

Dear Mr. Katz:

The PNC Financial Services Group, Inc. ("PNC"), Pittsburgh, Pennsylvania, appreciates this opportunity to provide comments on the Proposed Rules contained in Regulation B ("Proposed Rules") issued by the Securities and Exchange Commission ("SEC") (69 *Fed. Reg*. 39682 (June 30, 2004). Regulation B would provide exemptions for banks from the definition of the term "broker" under Section 3(a)(4) of the Exchange Act, as amended by Title II of the Gramm-Leach-Bliley Act of 1999 ("GLB Act").

PNC is one of the largest diversified financial services companies in the United States, with $73.1 billion in assets as of June 30, 2004. Its major businesses include regional community banking, wholesale banking, wealth management, asset management and global fund processing services. Through PNC's subsidiary banks, PNC Bank, National Association ("PNC Bank NA"), Pittsburgh, Pennsylvania, and PNC Bank, Delaware, Wilmington, Delaware, PNC has full-service banking offices in Delaware, Florida, Indiana, Kentucky, New Jersey, Ohio and Pennsylvania. Through its subsidiary banks and several affiliated companies, PNC engages in financial activities nationwide.

PNC engages in a full range of securities brokerage activities through three subsidiary registered broker-dealers, PNC Capital Markets, Inc., PNC Investments, LLC, and J.J.B. Hilliard, W.L. Lyons, Inc. ("Hilliard Lyons"), and provides investment advisory services through its registered investment advisors, including BlackRock, Inc., Hilliard Lyons, and PNC Investments, LLC. PNC also offers investment management, custody and fiduciary (including trust) services through departments of PNC Bank, NA and PNC Bank, Delaware, that are regularly examined by bank examiners for compliance with fiduciary principles and standards. As of June 30, 2004, PNC had approximately $310 billion in assets under management through BlackRock, Inc., and approximately $49 billion under management in the banks.

Also, through its subsidiary PFPC, Inc. ("PFPC"), Wilmington, Delaware, PNC provides a full range of services to mutual funds, partnerships and other pooled investment vehicles, both domestic and offshore, including accounting and administration services, transfer agency and shareholder services, fund custody and securities lending services, global fund services and subaccounting services. PFPC is the largest full-service transfer agent to the mutual fund industry in the United States. PFPC also offers mutual fund distribution services through its five broker-dealer subsidiaries: PFPC Distributors, Inc., Offit Funds Distributor, Inc., BlackRock Distributors, Inc., Northern Funds Distributors, LLC, and ABN Amro Distribution Services (USA), Inc.

In light of the various securities-related activities conducted by PNC, including those conducted through PNC Bank NA and PNC Bank, Delaware, PNC has a significant interest in the Proposed Rules. PNC was actively engaged, both directly and through banking trade associations, in the deliberations leading up to the enactment of the GLB Act, including Title II. PNC also commented, by letter dated July 17, 2001 ("PNC July 2001 Letter), on the Interim Final Rules that were published by the SEC on May 18, 2001, and participated actively in the drafting of comment letters by various trade associations.

PNC has also actively participated in discussions that have taken place both within the industry and with SEC staff in the period between the issuance of the Interim Final Rules and the Proposed Rules. PNC recognizes that SEC staff has expended significant time and effort in addressing these issues, and appreciates its reaching out to the banking industry through numerous, time consuming meetings. PNC would also note that it, together with other banking organizations and their trade associations, has expended significant time and resources on understanding the Interim Final Rules and Proposed Rules and the impact they would have on their businesses. However, as discussed below, PNC believes that the Proposed Rules do not implement the statutory provisions, but rather unnecessarily burden a bank's conduct of business that Congress intended banks to be able to continue to conduct. We would also submit that there have been no problems in the banks' conduct of these activities that would require such invasive regulation, and that overall impact of the rules would be to limit consumer choice, in addition to adding significant cost to the provision of these permissible banking products and services.

As was stated in the PNC July 2001 Letter, PNC thought it had a clear idea of the intent of Congress in enacting Title II, and was relatively confident that it was well positioned to comply with those provisions, based on the language of the statute and its understanding of the legislative intent underlying the statute. PNC, like the bank regulatory agencies, the bank trade associations, and numerous other banks, was surprised by, and disagreed with, the positions taken by SEC staff and the SEC's Interim

Final Rules regarding the "push-out" provisions.[1] Although the Proposed Rules address some of the issues raised by the commenters to the Interim Final Rules, numerous issues were not resolved and a number of new issues were created. Accordingly, PNC believes that the Proposed Rules, like the Interim Final Rules, are "in a number of critical respects contrary to the express statutory language in the exemptions and congressional intent," and create "an extremely burdensome regime of overly complex, costly and unworkable requirements that effectively negate the statutory exemptions and the congressional intent underlying those exemptions."[2] We should note that PNC has fully participated in the comment letters of The Clearing House Association LLC and the American Bankers Association/ABA Securities Association on the Proposed Rules ("Clearing House Letter" and "ABASA Letter," respectively). PNC strongly supports the views set forth in those letters that the Proposed Rules are not supported by the language or the legislative history of Title II of the GLBA, and that the SEC should reexamine the fundamental approach it has taken.

In this regard, we note that the sole purpose of section 201 of Title II was to replace the blanket exemption for banks from the broker provisions of the Securities Exchange Act of 1934 with eleven specific exceptions. This relatively straight-forward legislative language has been transformed into lengthy and extremely complex regulatory provisions. Rather than implementing the congressional intent of permitting banks to continue to provide trust, fiduciary, custodial and other traditional banking services to meet customers' financial needs, complex exemptions from almost all of the statutory exceptions have been created. We believe that both the Interim Final Rules and the Proposed Rules fundamentally misconstrued Title II, and we recommend that the SEC revisit its proposal in its entirety, with a view toward providing a simplified implementation of the statutory exemptive provisions.

While PNC is providing below both general and specific comments on how to address some of the issues in the Proposed Rules, we wish to make it clear that even if the specific recommended changes were made, for the reasons stated above the adopted rules might still be at variance with the statutory language of Title II and the congressional intent underlying these provisions. The recommended changes set forth below and in the Clearing House and ABASA Letters are ones that PNC believes are needed at a minimum. A better approach, however, would be to return to the intent of Congress and promulgate only those rules that are necessary to effect Congress' intent.

Process and Timing

It is our understanding that the SEC desires to have final rules in place prior to November 12, 2004, and that full compliance with the rules would be required on or

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[1] See, in this regard, letter dated June 29, 2001, from the Board of Governors of the Federal Reserve System ("Board"), the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency to Jonathan G. Katz ("Agency Letter") and its Appendix ("Agency Appendix").

[2] Agency Letter at 1.

about January 1, 2006. While SEC Exchange Act Release No. 47649 (April 8, 2003) extended the exemption from the definition of broker only until November 12, 2004, we believe that the SEC has full discretionary authority with respect to the effective date of the final rules, and we urge the SEC not to feel bound by the November 12 deadline. The complexity and importance of these rules cannot be overestimated.

Based on the numerous conference calls in which industry members have participated to discuss the Proposed Rules, and the apparent confusion that exists regarding the meaning of the Proposed Rules, especially when taken together with the Preamble to the Proposed Rules, we believe that it is quite clear that there is great uncertainty as to the meaning of many the provisions, and the impact on the operations of banking organizations is impossible to predict. In addition, the approach taken by the Proposed Rules, which in essence can be described as proposing numerous complicated regulatory exemptions to the rather straightforward statutory exceptions in Title II, would create significant operational, training and compliance burdens for most banking organizations, including PNC.

Accordingly, we would strongly recommend that the SEC: (1) take as much time as it needs to analyze and address the lengthy and thorough comments on the Proposed Rules, rather than feel constrained by the November 12, 2004 date; (2) give serious consideration to issuing another round of proposed rules for comment, as any changes to the Proposed Rules will undoubtedly require substantial additional analysis by the industry; and (3) also give serious consideration to a compliance period of more than one year. With respect to the last point, SEC staff has advised banking organizations not to begin making changes until final rules are in place. As discussed above, most banking organizations, including PNC, have determined that if the final rules in any way resemble the Proposed Rules significant operational and compliance changes would have to be made, and under these circumstances one year would appear to be a very short time period.

Discussion

I. <u>Trust and Fiduciary Activities</u>

We stated in PNC July 21 Letter on the Interim Final Rules that those rules in a number of ways were contrary to the GLB Act's exception for trust and fiduciary activities. That is true also of the Proposed Rules. The Proposed Rules impose requirements, not found in the statute, that effectively negate the availability of the exception. This result is contrary to the congressional intent that traditional bank trust and fiduciary activities not be disturbed by the SEC's rules.[3] Trust and fiduciary products and services have long been offered to bank customers subject to comprehensive legal requirements that offer extensive customer protections. Bank examiners regularly examine these activities for compliance with trust and fiduciary principles, and would be

[3] *See* S. Rep. No. 106-44 at 10 (1999).

fully able to determine if a bank failed to conform to those principles in its trust and fiduciary operations. In light of the extensive regulation of bank trust and fiduciary activities, and the lack of any significant problems in this area, Congress adopted the exception to permit banks to continue providing these traditional customer services.[4]

Like the Interim Final Rules, the Proposed Rules also fail to recognize the fundamental reality of the trust business: state laws typically limit which corporations may serve as trustees. Banks and trust companies, but not broker-dealers, generally are authorized to act as trustees subject to a comprehensive regulatory scheme under state and Federal law. If the Proposed Rules force trust activities out of banks, customers will have fragmented relationships with their chosen trustee and a third-party broker-dealer, and be burdened with additional costs that are unnecessary in light of the strong protections already afforded by the fiduciary requirements imposed on trustees and the GLB Act's requirement that transactions in publicly traded securities be executed by a registered broker-dealer.

A. <u>Chiefly Compensated</u>

Although Congress sought to preserve the traditional trust and fiduciary activities of banks, Congress conditioned the exception for trust and fiduciary activities by requiring a bank to be "chiefly compensated" for its trustee or fiduciary related transactions on the basis of non-brokerage related fees <u>and</u> by prohibiting the bank from publicly soliciting brokerage business. Congress also concluded that the trust and fiduciary laws and the oversight by Federal and state banking agencies provide sufficient consumer protection for the customers of banks that operate within the statutory standards.

The GLB Act and its legislative history suggest that the chiefly compensated limit should be applied on an aggregate basis to the bank's trust and fiduciary activities, and not on an account-by-account basis, to achieve its purpose.[5] Although the Proposed Rules purportedly improve upon the scheme in the Interim Final Rules, and permit banking organizations to meet the chiefly compensated test on a line-of-business basis, the line-of business calculation appears to be premised on the view that the statute requires "chiefly compensated" to be determined in the first instance on an account-by-account basis. Accordingly, whereas the Proposed Rules would permit an account-by-account calculation to rely upon a definition of "chiefly compensated" as greater than 50 percent (that is sales compensation could account for up to 49.99 percent of the revenue

[4] The Senate Report states "Banks have historically provided securities services largely through their trust departments, or as an accommodation to certain customers. Banks are uniquely qualified to provide these services and have done so without any problems for years. Banks provided trust services under the strict mandates of State trust and fiduciary law without problems long before Glass-Steagall was enacted; there is no compelling policy reason for changing Federal regulation of bank trust departments, solely because Glass-Steagall is being modified." S. Rep. No. 106-44 at 10 (1999).

[5] *See* H.R. Rep. No. 106-74, pt. 3, at 164 (1999). (A "bank must be chiefly compensated for its <u>trust and fiduciary activities</u>" on the basis of the fees specified by the Act.) (Emphasis added).

of an account), a bank using the line-of-business basis would have to have almost 90 percent of its revenue derived from non-sales compensation. Also, the scheme proposed by the SEC is so complicated that it could be difficult for a bank to avoid having to make the account-by-account calculations, a calculation that few if any large banking organizations could make using their existing systems and data collection.
While we believe that the statutory language would permit a banking organization to be in compliance with the chiefly compensated test if 50.1 percent of its compensation on a line of business basis were non-sales related, we are nevertheless fully supportive of the proposal with respect to the chiefly compensated test set forth in the Clearing House and ABASA Letters.

(1) Sales Compensation: Fee Paid by an Investment Company

As an example of a specific problem in the Proposed Rules in the calculation of "chiefly compensated," we would note that the definition of "sales compensation" in section 242.724(i) of the Proposed Rules excludes from sales compensation charges for seven enumerated services that are not considered charges for personal service for the maintenance of shareholder accounts (see section 242.724(i)(6)(i)-(vii)). Although PNC believes that the reference in that section to "a fee paid by an investment company" is meant to apply only to the fees that are included in the term "sales compensation," there is an implication that the payor for such services provided by a bank must be the investment company itself in order for the payments set forth in section 242.724(i)(6)(i)-(vii) not to be included as sales compensation.

PNC proposes that the rule be clarified to make it clear that such payments are not sales compensation regardless of whether the payor is the investment company or an affiliate of, or service provider to, the investment company. Most states have statutes that allow corporate fiduciaries of non-ERISA accounts to receive service fees, provided they are disclosed. A bank, therefore, is required by applicable law to know for which accounts it may accept such fees, what to disclose and to whom it is required to make disclosure. The state statutes make no distinction as to the source of the payment to the bank. Service fees paid by the adviser, administrator or other service provider to the investment company compensate banks for the same recordkeeping functions as do payments that come directly from the investment company.

B. Definition of Trustee and Fiduciary Capacity

We appreciate the SEC's action to address the comments regarding the restrictive definition of "trustee capacity" in the Interim Final Rule. In addressing this general issue, the SEC proposed section 770, which would provide an exemption from the definition of "broker" for banks effecting transactions in securities in certain employee benefit plans. Instead of providing a straightforward exemption, however, the SEC has proposed a series of complex conditions to and exemptions from the exemption. As is discussed at length in a comment letter that PNC joined,[6] each type of employee benefit plan requires a specialized array of administrative and management services in order to provide benefits in accordance with often complex plan terms and also to meet legal requirements under the Internal Revenue Code of 1986, as amended, the Employee Retirement Income Security Act of 974, as amended ("ERISA") or, where ERISA does no apply, state law. Accordingly, PNC urges the SEC to consider carefully the thorough discussion and thoughtful recommendations set forth in the Ufford letter.

C. Investment Advisory Activities for a Fee

We believe that there is no need for the SEC to define the term "investment adviser if the bank receives a fee for its investment advice." (See Section 242.724(d).) The only effect of such a definition is to place unnecessary burdens on a bank's conduct of an aspect of its traditional business that the GLB Act specifically permits banks to continue to conduct. It serves no investor protection function. Part 9 of the regulations of the Office of the Comptroller of the Currency (Fiduciary Activities of National Banks (12 C.F.R. § 9.1(e)) defines "fiduciary capacity" to include "investment adviser, if the bank receives a fee for its investment advice" and provides guidance to banks on the conduct of fiduciary activities.

Therefore, it is unnecessary for the SEC to adopt a rule to impose separately a duty of loyalty, and certainly unnecessary for the SEC to prescribe the way in which a bank demonstrates compliance with its fiduciary duties, including the form of disclosure. This is the province of the bank regulators and applicable state law. With respect to the SEC prescribing a particular disclosure regime, the GLB Act retains a bank's exemption from registration as an investment adviser under the Investment Advisers Act of 1940 ("Advisers Act") (except for a bank that advises a registered investment company). Accordingly, a bank is not subject to the Advisers Act brochure requirement. The SEC should not be able to impose a requirement upon banks that Congress specifically chose not to impose.

It is also unnecessary to limit this statutory exceptioin to only those banks giving advice regarding "specific securities." Often banks are engaged by clients to give asset allocation advice and may be authorized to recommend, engage and monitor sub-advisors who make the actual security selections. The OCC has provided a definition of "providing advice for a fee" in 12 C.F.R. § 9.101. PNC believes that the OCC's reference to "generally means ... advice or recommendations concerning the purchase and sale of specific securities" is meant to be illustrative and not exclusive. For all of these reasons, PNC recommends that the definition of "investment adviser if the bank receives a fee for its investment advice" be eliminated in its entirety as unnecessary.

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[6] Letter dated September 1, 2004, to Jonathan G. Katz, Secretary, SEC, from Roberta J. Ufford ("Ufford Letter").

II. Custody and Safekeeping

A. Order-Taking

We believe that the Custody and Safekeeping Exception was intended to permit banks to continue to provide customers the custody and safekeeping services, including incidental and related securities execution services, that they traditionally have provided as part of their customary banking activities. The SEC's interpretation of the Custody and Safekeeping Exception would disrupt the traditional custody and safekeeping activities of banks that Congress intended to protect. Accordingly, we respectfully suggest that the SEC's interpretation of the Custody and Safekeeping Exception in the Proposed Rules is inconsistent with the statute and Congress' intent because it would not permit banks to continue to provide the custody and safekeeping services, including the securities order-taking services, that they have long-provided as part of their customary banking activities. Customers might decide to forgo establishing custodial relationships with banks or to move existing custodial relationships out of the bank. The end result would be the impairment of core banking functions that Congress intended to remain within the bank and the elimination of choice of financial services providers for customers.

For example, banks have long-provided securities execution services to self-directed IRA accounts for which the bank acts as custodian.[7] Applicable Internal Revenue Service regulations generally require that a bank serve as trustee or custodian for an IRA,[8] and thousands of banks offer self-directed custodial IRA services to their customers. Bank-offered custodial IRAs provide consumers throughout the United States a convenient and economical way to invest for retirement on a tax-deferred basis. Bank-offered custodial IRA services are subject to strict regulation under the Internal Revenue Code, are subject to regular supervision by the bank regulatory agencies, and have been offered by banks for years without creating consumer protection concerns.

Because banks generally must serve as the custodian for custodial IRA accounts, providing securities execution services to these accounts allows the public to avoid the unnecessary expenses and administrative complexities associated with establishing a separate account at a broker-dealer. Moreover, where a bank serves as custodian for a self-directed IRA, the bank directs the customer's securities transactions to a registered

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[7] If a bank serves as a trustee to an IRA, has investment discretion over an IRA account, or provides investment advice to the accountholder for a fee, the bank may effect securities transactions for the IRA under the statute's Trust and Fiduciary Exception. Accordingly, this discussion focuses on accounts for which transactions could only be conducted under the Custody and Safekeeping Exception, i.e. self-directed custodial IRAs where the bank does not provide investment advice to customers.

[8] *See* 26 C.F.R. § 1.408-2(b)(2)(i) and (d). Other types of entities or persons may act as a trustee or custodian for an IRA but only if the Commissioner of the Internal Revenue Service determines that the person or entity will administer the IRA in the manner required by law.

broker-dealer for execution and would be required to continue doing so under the GLB Act.[9]

In addition, banks provide custodial and safekeeping services to 401(k) and other retirement and benefit plans where a third party acts as trustee and/or investment adviser to the plan. Frequently, banks offer these services as part of a bundle of recordkeeping, reporting, tax-preparation and administrative services for 401(k) and other plans. As the SEC has itself recognized, banks offering such a bundle of custodial and administrative services may accept and process orders from the plan trustee or investment adviser or the plan's participants for the investment of new contributions or the re-allocation of existing contributions.[10] In these circumstances, the custodial bank performs its order-taking and order-execution functions pursuant to the direction and supervision of one or more plan fiduciaries.[11] These bank-offered services allow plan administrators to obtain securities execution and other administrative services in a cost-effective manner, thereby reducing plan expenses and benefiting plan beneficiaries.

As the SEC also has recognized, banks as part of their customary banking activities effect securities trades as an accommodation to their custodial customers.[12] This customer-driven service allows customers to avoid having to go through the unnecessary expense of establishing a separate account with a broker-dealer to effect occasional trades associated with the customer's custodial assets. Furthermore, because these services are customarily provided only as an accommodation to custodial accounts, banks typically seek to recover only the costs incurred in placing the trade and settling for the customer. While the banking regulators and banks have referred to these services as being provided as an "accommodation" to customers, one should not overlook the importance to banks of being able to continue to accommodate the reasonable requests of customers for lawful services.

We believe that the Custody and Safekeeping Exception enables banks to continue the custody and safekeeping activities that banks have provided as part of their customary banking activities, including the securities order-taking activities described above. The exception is not "open-ended" and would not allow banks to offer general brokerage services to the public in contravention of the GLB Act. For all of these

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[9] *See* 15 U.S.C. § 78c(a)(4)(C).

[10] *See* Universal Pensions, Inc., 1998 SEC No-Act. LEXIS 192 (Jan. 30, 1998).

[11] Under Department of Labor regulations, a bank may provide securities execution services to an ERISA plan without becoming a "fiduciary" to the plan so long as the transactions are conducted pursuant to instructions received from a plan fiduciary that is not an affiliate of the bank. See 29 C.F.R. § 2510.3-21(d).

[12] *See* Provident National Bank, 1986 SEC No-Act. LEXIS 2782 (Oct. 6, 1982) (noting that the bank, as part of its custody services, offered a broad range of clerical and administrative services including access to the bank's trading department for the purchase and sale of securities at the customer's instructions).

reasons, PNC respectfully suggests that sections 240.760 through 240.762 of the Proposed Rules are unnecessary and should be deleted.

B. Definition of an Account for which a Bank Acts as a Custodian

PNC also believes that the SEC has further complicated the offering of custody services by banking organizations by including in section 242.762(a) of the Proposed Rules a definition of an "account for which the bank acts as a custodian." This definition was not included in the Interim Final Rules, and PNC believes that there is nothing in Title II that would mandate defining such an account. The custodial functions of banks are governed by regulations issued by the primary bank regulators.

Furthermore, in creating this definition, the SEC would impose an undue burden on banks by prescribing seven specific items governing fees payable, rights and obligations of the bank that would be required in each custody agreement in order for a bank to rely on the custody exception (see section 242.762(a)(1)(i)-(vii)). Complying with such a requirement would be a major undertaking for a banking organization as it would require a review of all existing custody agreements and could require the redocumentation of many, if not all, existing custody accounts and modification of standard agreements, without providing any additional investor protections. PNC does not believe that Congress intended to impose such a burden on banks when it provided an exemption so that banks could continue conducting their traditional custody business.

III. Sweep Accounts

The GLB Act allows banks to sweep deposit funds into a "no-load" money market mutual fund (the "Sweeps Exception").[13] The Interim Final Rules and now the Proposed Rules generally adopt the definition of "no-load" that the NASD has adopted in its Rule 2830(d)(4). That rule prohibits an investment company from being advertised as "no-load" if "the investment company has a front-end or deferred sales charge or [imposes] total charges against net assets to provide for sales related expenses and/or service fees [that] exceed .25 of 1 percent of average net assets per annum."[14]

PNC believes that the SEC rules should not incorporate the interpretation of "no-load" adopted by the NASD. First, as the SEC itself noted, the interpretation of "no-load" by the NASD in Rule 2830(d)(4) was intended to address the circumstances in which investment companies can be advertised as "no load" in light of the SEC's Rule 12b-1 permitting investment companies to use their assets to finance distribution expenses.[15] The use of the term "no-load" in the Sweeps Exception is used in an entirely different context than the NASD Rule.

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[13] 15 U.S.C. § 78c(a)(4)(B)(v).

[14] NASD Rule 2830(d)(4).

[15] 66 *Fed. Reg.* at 27779.

Second, early legislative and regulatory versions of the Sweeps Exception included the term “no-load” long before the NASD adopted its interpretation. Senate bill S. 1886 in the 100th Congress used the term in the Sweeps Exception and the SEC also used the term when it adopted a similar sweeps exception in the now-defunct Rule 3b-9.[16] Third, neither the Investment Company Act of 1940, the federal statute governing mutual funds, nor the SEC’s regulations and forms promulgated thereunder use the NASD’s interpretation when referencing sales loads.[17]

We believe that it is not necessary to interpret “no-load” to include funds that impose asset-based sales and other charges in excess of 25 basis points, and that the SEC’s current position will impose a significant burden on the administration of bank sweeps programs without providing a commensurate level of protection to sweeps customers. Bank customers already receive appropriate disclosures concerning any fees charged in connection with a sweep account—including any Rule 12b-1 and other fees charged by the relevant money market mutual fund—from the bank.

The SEC’s “no-load” interpretation would prevent PNC Bank NA from operating some of its sweeps programs in the manner in which they have been conducted for years. As a result, PNC Bank NA would have to incur significant administrative expense in revising some of its programs to meet the SEC definition of “no-load,” while providing no additional benefit to, and in fact inconveniencing, its customers. PNC Bank NA, like other banks that would have to revise their sweeps programs to accommodate this definition of “no load,” would increase the deposit account or other fees it charges sweeps customers to make up for the loss of fees paid by the money market mutual fund that it could no longer accept. This would limit the flexibility of the pricing of the sweeps service, and would replace a highly negotiated fee, which customers appreciate, with inflexible, non-negotiable monthly service fees. Banks would receive the same amount of income for their sweeps services, customers would be limited in how these fees could be structured, and the increased costs of amending fee schedules would be paid by banks and customers alike.

The SEC has also requested comment on whether rate spread or retained yield fees should be counted as sales charges in determining whether money market funds in a sweep account program involving such fees should be considered “no-load” for purposes of the exception. Rate spread or retained yield fees are collected by withholding part of the dividend income paid on a customer’s sweep assets. This is accomplished by collecting dividends for all customers from the fund, calculating a charge based on the average assets held in the fund by each customer multiplied by a rate, and deducting this charge from the customer’s dividend before the income is passed to the customer. In

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[16] *See* Proxmire Financial Modernization Act of 1988, S. 1886, 100th Cong. § 301 (1988); 12 C.F.R § 240.3b-9(b)(4).

[17] Section 2(a)(35), 15 U.S.C. 80a-2(a)(35); Rule 6c-10, 17 CFR 270.6c-10; and Form N-1A, 17 CFR 274.11A.

many cases these fees are tiered or individually negotiated so that the rate applied to each customer may be different. Spread fees are used to charge clients using sweep services appropriately based on assets held, recognizing that as a client's sweep balances grow, the rate at which the fee is calculated should decrease. These fees are collected outside the fund, and are forms of direct charges to individual customers for sweep services. Including this form of fee calculation when determining whether a fund is no-load would limit the bank's ability to charge direct fees based on assets held. Therefore, they should not be counted as sales charges in determining whether a money market fund is no-load.

V. Employee Compensation

A. Referral Fees

The GLB Act permits banks to enter into arrangements with registered broker-dealers to offer brokerage services to bank customers provided the "networking" arrangement meets certain requirements specified in the Act.[18] One of the requirements is that bank employees (other than employees also employed by the broker-dealer who are registered with the NASD or another self-regulatory organization (i.e., "dual employees")) 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."[19]

PNC believes that the SEC's interpretation of the term "nominal one-time cash fee of a fixed dollar amount" imposes unnecessary limitations on the securities referral programs of banks that are not required by statute, create burdensome practical difficulties for banks, are inconsistent with the SEC's own practice, and raise employee privacy concerns. These limits are not found in the words of the statute and the legislative history does not suggest that such severe restrictions were intended by Congress.

The SEC staff has long taken the position in no-action letters involving networking arrangements with banks, thrifts and others that the registration requirements of the Securities Exchange Act of 1934 are not triggered by networking arrangements in which a bank employee receives a "nominal fee" for referrals to the registered broker-dealer.[20] As the SEC has acknowledged, the GLB Act's networking exception is based on these letters and was intended to codify the existing framework that has long-governed

[18] 15 U.S.C. § 78c(a)(4)(B)(i).

[19] Id. at § 78c(a)(4)(B)(i)(VI).

[20] *See, e.g.,* Chubb Securities Corp., 1993 SEC No-Act. LEXIS 1204 (Nov. 24, 1993) ("Chubb Letter"); Independence One Bank of California and BHS Service Corp., 1993 SEC No-Act. LEXIS 620 (Apr. 6, 1993).

these arrangements.[21] In none of these precedents, however, has the SEC staff provided additional guidance on the form of payments these nominal fees may represent or imposed limits on referral fees or bonus programs similar to those provided in the Interim Final Rules. The Chubb Letter specifically states: "Unregistered employees [of the Financial Institutions] may, however, be paid a nominal fee for referring Financial Institution customers to CSC. The amount of any such fees, which will be unrelated to the volume of securities traded by the customer, <u>will be determined and paid by the Financial Institution (or required service corporation)</u>."[22]

PNC Bank NA and PNC Bank, Delaware, have conducted their referral fee programs in a manner that is consistent with the Chubb Letter and the Interagency Statement on Retail Sales of Nondeposit Investment Products (February 15, 1994), both of which allow depository institution employees to receive a one-time nominal fee of a fixed dollar amount for each retail customer referral for nondeposit investment products. These referrals are critical to the growth of the businesses of PNC's broker-dealer subsidiaries, and restrictions on such referrals similar to those in the Proposed Rules could have a material impact on the growth and profitability of these businesses. PNC is unaware of any issues that have been raised by the networking arrangements that are currently in place, and it would appear that Congress was similarly comfortable with the regime implemented by the bank regulatory agencies and the SEC, as is reflected in the statutory language of the Networking Exception in Title II.

For the reasons discussed above, we strongly <u>recommend</u> that the SEC allow banks, consistent with its current practice, to interpret the term "nominal one-time cash fee of a fixed dollar amount" in a manner that best fits their networking arrangements. In the alternative, we strongly support the position of the Clearing House and ABASA letters on this issue.

B. <u>Bonus Plans</u>

Section 242.710(b)(3)(iii) and the discussion that accompanies it would place restrictions on bank and bank holding company employee bonus plans. PNC believes that these plans are properly subject to the supervision of the appropriate bank regulatory agency. Accordingly, unless there were evidence that a bonus plan was being used for the payment of specific transaction-related referral fees, we believe that supervisory and regulatory oversight of bonus plans should be carried out by the bank regulatory agencies.[23]

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[21] *See* 66 *Fed. Reg.* at 27765, n.38.

[22] Chubb Letter at 7. (Emphasis added).

[23] *See* Agency Appendix at 36.

VI. Purchase of Mutual Fund Shares

The GLB Act requires a bank relying on either the Trust and Fiduciary exception or the Custody Exception to direct trades in "publicly traded" securities to a registered broker-dealer for execution. PNC believes that the shares of registered open-end investment companies (commonly called “mutual funds”) are not “publicly traded.” Mutual fund shares are not traded on a securities exchange or in a secondary market for which investors would need the protections of a registered broker-dealer. Mutual fund shares are issued and redeemed by the fund itself at net asset value as determined in accordance with the requirements of the Investment Company Act of 1940, as amended, and the rules thereunder.

Accordingly, PNC believes that section 242.775 should be withdrawn as unnecessary. If the SEC does not withdraw this proposed rule, PNC requests that the conditions included in the Proposed Rules be eliminated. The SEC has conditioned a bank’s ability to purchase and seek redemption of mutual fund shares directly with the fund’s transfer agent upon the transfer agent not receiving any compensation for distribution. This is information that a bank would not have and should not be burdened with having to obtain and monitor. Nor should a bank be required to know whether the fund has a distributor that is a registered broker-dealer.

Conclusion

PNC appreciates this opportunity to submit its views on the SEC’s Proposed Rules, as well as the willingness of SEC commissioners and staff members to meet with banking industry representatives to discuss the issues raised by the GLB Act and this rulemaking. We look forward to continuing to work closely with the SEC and its staff in arriving at final rules that address the concerns of the SEC and at the same time allow banks to be able to continue to engage in permissible securities-related activities without being subjected to unnecessary regulatory burdens. We also urge the SEC to take into consideration our comments regarding the timing of the adoption of final rules, the ability of interested parties to comment further on the SEC’s issuance of the next round of rules, and the effective date of any rules adopted.

Please feel free to contact the undersigned if you wish to discuss matters raised by this letter.

Sincerely,

James S. Keller

James S. Keller

cc: Gary TeKolste
Office of the Comptroller of the Currency

Michael Carroll
Federal Reserve Bank of Cleveland

Leah Tompkins
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