September 1, 2004

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

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

Dear Mr. Katz:

Mellon Bank, N.A. ("Mellon") is the lead national bank subsidiary of Mellon Financial Corporation ("MFC"), a financial services company headquartered in Pittsburgh, Pennsylvania. MFC's subsidiaries offer traditional banking services for individuals and corporations and collectively are one of the world's leading providers of asset management, trust, custody and benefits consulting services. They have approximately $3.6 trillion in assets under management, administration or custody, including $675 billion in assets under management. MFC is a bank holding company and is the direct or indirect sole shareholder of four full service national banks (Mellon Bank, N.A., Mellon Trust of New England, National Association, Mellon United National Bank, and Mellon 1st Business Bank, National Association), two limited purpose national banks (Mellon Private Trust Company, National Association and Mellon Trust of Delaware, National Association) and five trust companies chartered by the states of Illinois, New York, California and Washington (Mellon Trust Company of Illinois, Dreyfus Trust Company, Mellon Trust of New York, Mellon Trust of California, and Mellon Trust of Washington, respectively).

Mellon appreciates the opportunity to provide comments on the various rules proposed to be adopted (the "Proposed Rules") by the Securities and Exchange Commission (the "Commission") under the Exchange Act contained in a new Regulation B. The Proposed Rules interpret the terms of the exclusions for banks from the definition of broker in Section 3(a)(4) of the Exchange Act as amended by the Gramm-Leach-Bliley Act (the "GLBA") and provide additional exemptions to banks from the Exchange Act's broker-dealer registration requirements. We also appreciate the substantial efforts of the Commission and its staff in preparing the Proposed Rules.

In addition to the following comments on the Proposed Rules, we have contributed to and support the letters filed by the American Bankers Association, the Clearing House Association L.L.C., and The Financial Services Roundtable.

Generally, we believe, as we have indicated in earlier comments, that the implementation of the Proposed Rules in a number of ways would be costly and extremely burdensome, disrupt traditional banking businesses that Mellon has been engaged in since 1869, and in some cases compel Mellon to change the way it has conducted its trust business. The Proposed Rules fail to appropriately take into consideration the impact the proposed changes will have on a bank's long historical and traditional relationships with its customers and by attempting to expand the Commission's jurisdiction over traditional bank activities, the Proposed Rules will introduce additional regulatory oversight without any evidence of customer abuse that would warrant such additional oversight. Furthermore, despite the changes the Commission has made in its position since the issuance of the interim final rules in May 2001("Interim Final Rules"), the Proposed Rules continue to go well beyond Congressional intent and are not consistent with the concept of functional regulation.

This letter will address the major concerns we have with respect to specific exceptions and exemptions.

Custody and Safekeeping Activities

We believe that the "custody and safekeeping exception" was intended to allow a bank to continue to provide its traditional custody services, including order taking which is a customary component of historical custodial services. Providing securities execution services is an integral part of these custodial relationships and is intended to allow customers to avoid the expense and burdens associated with establishing a separate account at a broker-dealer. The language of GLBA clearly reflects that it recognizes that a custodian may execute trades for its customers since it requires that such trades for publicly traded securities be directed to a registered broker-dealer. However, the Commission has taken the inexplicable position that the custody and safekeeping exception does not permit banks to accept securities orders.

The Commission's position will unnecessarily interfere with historical banking activities that Congress clearly intended to protect and is inconsistent with the GLBA and the purposes of the custody and safekeeping exception.

Although the Commission has granted exemption under Proposed Rule 760 for the execution of custodial-related transactions, the conditions of this exemption undermine its usefulness.

Proposed Rule 760 inappropriately limits the availability of the custody order-taking exemption to "qualified investors" and to customers with accounts opened before July 30, 2004. However, there is no indication that customers who are not "qualified investors" have suffered any harm in placing orders to purchase or sell securities through their banks' custody department. Nor is there any evidence that custody accounts in which a customer places orders are used as a substitute brokerage account. Rather, customers choose banks to provide custodial services because they desire the safety of having their assets held by a bank in a centralized location as well as having the ability to access the necessary related services which include class action processing, income and principal accounting and corporate action processing. For example, a bank may provide fiduciary and custody services to various family groups who want their fiduciary services and custody services provided in a centralized place. Also, a bank may serve as investment manager and custodian with respect to a portion of a customer's portfolio, but the customer would still want to place securities trade orders with respect to another portion of his assets for which the bank serves as custodian. In neither of these cases does the bank offer custodial services as a way to solicit trading activity and no sales commissions are paid for trades. However, if the customer does not come within the exemption, the customer would have to establish a brokerage account to place security trade orders and maintain a separate custody account with the bank to hold the customer's assets and provide services associated with a bank custodial account.

For these reasons we believe the Proposed Rule 760(a) should be amended to extend the scope of the order-taking exemption to all custody customers. If the Commission disagrees with our position, the order-taking exemption should be revised to include any account managed by a registered investment advisor, any account of an "accredited investor," as that term is defined Regulation D under the Securities Act of 1933, and any account managed by a trustee that itself is an "accredited investor". In determining whether a customer is an accredited investor, the bank should be permitted to include not only the assets of the customer establishing the custody account, but also the assets of related family members and corporate affiliates who have trust, investment or custody accounts with the Bank. In addition, any customer who has an investment management account should be able to place orders for assets custodied by the bank, but not managed by the bank.

The Release requires that the bank not be permitted to "solicit through another bank department securities activities in its custody department". We do not object to restricting the custody department's ability to solicit order taking. However, we believe the extension of these restrictions to other departments of the bank is unnecessary and burdensome. Trust departments should be able to market their fiduciary services, including offering them to custody customers.

Finally, the Commission defines the term "account for which the bank acts as a custodian" as one established "by written agreement between the bank and the customer, which at a minimum provides for the terms that will govern the fees payable, rights and obligations of the bank" regarding the various tasks performed by a bank acting as a custodian. This restriction would require the bank to review and in some cases re-document its existing custody relationships with its customers. This will add further unnecessary complexity and likely customer confusion to implementation of the Proposed Rules without adding any real customer benefits.

Sweep Activities

In providing the "sweep exception" it was the clear intent of Congress to allow banks, as they had pre-GLBA, to continue to sweep cash from deposit accounts into a "no-load" mutual fund. The Interim Final Rules generally adopted the definition of "no-load" that the NASD has adopted in its Rule 2830(d)(4). Specifically, Interim Final Rule 3b-17(e) provided that a fund is "no-load" if: (1) purchases of the mutual fund's shares are not subject to a sales load or a deferred sales load and (2) its total charges against net assets that provide for sales or sales promotion expenses for personal services or the maintenance of shareholder accounts do not exceed 0.25 % of average net assets annually and are disclosed in the mutual fund's prospectus. Regulation B, however, amends this definition of "no-load" to refer instead to a load that is applicable to a class or series of an investment company's security, rather than simply to the securities of an investment company in general.

We believe that Rule 2830(d)(4) was intended to address circumstances in which mutual funds can be advertised as "no load', which is a completely different context than the "sweep exception". With respect to the sweep exception, it is not necessary to impose the 25 basis point limit since bank customers already receive appropriate disclosure concerning fees charged in connection with a sweep account. In addition, this requirement could result in banks increasing the account fees they charge sweep customers to make up for the fees that they can no longer receive from money market mutual funds. Thus, the imposition of this limitation provides no significant benefit to sweep customers, could actually result in an additional cost to customers, and would prevent banks from operating sweep programs in the manner in which they have been operating for years without any evidence of a harm that needs to be addressed.

The Commission indicates in the Release that in addition to receiving 12b-1 fees, the banks might directly charge customers “rate spread fees” or “retained yield fees”, which represent “the difference between the return that the money market fund pays the bank’s customer whose deposit funds are swept into the fund and the fee the bank charges the customer for the sweep service”. The Commission is soliciting comment on whether “rate spread” or “retained yield fees” should be counted as “sales charges”. Since these are fees that a bank charges its customers, and not fees paid by the mutual fund to the bank, we do not believe that “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.

Finally, we do not think that it is necessary to define the term “program”, and specifically disagree with the Commission’s interpretation that a program should be limited to the automatic transfer of funds on a regular basis. From time to time the customer may wish to establish limits on the amount swept or otherwise actively manages its participation in the sweep program. The Commission’s definition of “program” would exclude such existing sweep arrangements that the statute clearly intended to except from registration.

Trust and Fiduciary Service Activities

The trust and fiduciary exception in GLBA broadly authorizes a bank, without the need to register as a broker-dealer, to effect securities transactions in a trustee capacity, or in a fiduciary capacity in its trust department or other department that is regularly examined by bank examiners for compliance with fiduciary principles and standards, so long as the bank: (1) is chiefly compensated for such transactions, consistent with fiduciary principles and standards, on the basis of (i) an administration or annual fee (payable on a monthly, quarterly or other basis), (ii) a percentage of assets under management, (iii) a flat or capped per order processing fee equal to not more than the cost incurred by the bank in connection with executing securities transactions for its trust and fiduciary customers, or (iv) any combination of such fees and (2) does not publicly solicit brokerage business (other than by advertising that it effects transactions in securities in conjunction with advertising its other trust activities).

The Interim Final Rules refer to the compensation described in GLBA's statutory exception as "relationship compensation," and provide that "relationship compensation" received from each trust and fiduciary account must exceed the "sales compensation" (which is compensation other than (i), (ii), (iii) and (iv) above) received from the account during the immediately preceding year. The Commission also created a category designated as "unrelated compensation", which includes fees charged separately for any activity of a bank not related to securities transactions. The Commission takes the position that unrelated compensation must be excluded from any calculation used for determining whether the bank meets the chiefly compensated test.

The Commission has expanded the definition of "relationship compensation" to include revenues received for managing non-securities assets (a long traditional bank trust function), created a safe harbor for occasional failures to meet the requirements of the "chiefly compensated test", and grandfathered existing living, testamentary and charitable trust accounts. However, even with these improvements to the Commission's proposed rules, it would be costly, inefficient, and difficult to monitor compliance with the "chiefly compensated" test on an account-by account basis. Since there is no evidence of any customer abuse by bank trust departments there is no corresponding benefit to an account-by-account analysis. Thus, it would seem that we would still need to rely on the line of business exemption contained in Proposed Rule 721.

We have several concerns, however, with Proposed Rule 721.

In performing the "chiefly compensated" test, excluding "unrelated compensation" from the calculation is burdensome and unreasonable and would require the development of special accounting systems. We believe that if "sales compensation" were measured against all revenues received in connection with a bank's trust and fiduciary activities, the calculation could be greatly simplified and the same objective attained.

The Release suggests that under the costly and inefficient line-of-business exemption, banks will have to treat as "sales compensation" revenues from activities excluded under other exemptions or exceptions, if such revenues would otherwise qualify as "sales compensation" under the fiduciary exception. It does not make sense to provide an account that might not qualify for the fiduciary exception with an alternative exemption or exception, and then require the account's compensation to be considered in calculating the chiefly compensated test of the fiduciary exception. The Commission should confirm that revenues from transactions that qualify for another exemptive rule should not be deemed as "sales compensation" under Proposed Rule 721(c).

Proposed Rule 721(a)(4) requires a bank to review each account to examine the ratio of “sales” to “relationship” compensation when the bank “individually negotiates with the accountholder or beneficiary of the account to increase the proportion of sales compensation as compared to relationship compensation”. In the Release, the Commission asked whether this review is necessary if there is a ratio change resulting from the bank’s decision to waive relationship fees. We believe that this review should not be necessary when there is a reduction in “relationship compensation” resulting from the bank’s decision to waive fees that qualify as relationship compensation.

In some cases, particularly in the institutional trust area, the bank serves as “directed trustee”. In those cases, an investment manager hired by the Settlor of the trust, or the Settlor itself, arranges the trust’s securities transactions with a registered broker, and is responsible for negotiating the terms of the transaction. As directed trustee, the bank is responsible for clearing and settling the investment transactions executed by the broker-dealer and maintaining custody of the plan's securities. These services are an important component of the services provided by banks acting as directed trustee. We are requesting confirmation that the compensation received for clearing and settling such trades should be treated as “relationship compensation”.

Proposed Rule 724(e) requires that a “line of business” be an “identifiable department unit, or division of a bank organized and operated on an ongoing basis for business reasons” and that a line of business consist of “similar type of accounts…for which the bank acts in a similar type of fiduciary capacity.” This definition is too vague and potentially could disrupt the way business lines have been developed, which may be based on customer relationships, rather than account type or capacity.

Employee Benefit Plan Exemption

We appreciate the Commission’s recognition of the special requirements of employee benefit plans and the fact that Rule 770 provides an exemption for certain services banks provide to employee benefit plans. However, we believe that Rule 770 does not accommodate banks' current business practices, and the Commission should adopt a rule that would grant banks a complete exemption from the definition of the term "broker" to the extent that banks effect transactions for employee benefit plans. We would also support a general exemption that would cover situations where 1) the bank acting in the capacity of fiduciary, trustee, or custodian effects securities transactions for qualified investors in conjunction with the provisions of securities processing, investment servicing, or investment management services; or 2) the bank has a contractual arrangement with its own broker-dealer affiliate involving the referral of qualified investors for brokerage services. If neither of these broad exemptions is adopted, the Commission should at least make the following four suggested changes to Rule 770:

(1) Delete the requirement that banks offset or credit compensation received from mutual fund complexes against other plan fees on a dollar for dollar basis. This condition is unnecessary in light of guidance issued by the U.S. Department of Labor, which generally permits banks to receive payments from mutual fund complexes as part of their compensation for plan services without such an offset, under conditions (including disclosure requirements) protective of plans and plan participants. See DOL Adv. Ops. 2003-09A (June 25, 2003), 1997-16A (May 22, 1997), and 1997-15A (May 22, 2997).

(2) Proposed Rule 770 should also be available where banks provide services to church plans described by section 414(e) of the Internal Revenue Code of 1986, as amended (the "Code"), governmental plans as described by Code sections 414(d), "voluntary employee benefit associations" (VEBAs) established under Code section 501(c)(9), and non-qualified deferred compensation plans. These types of plans receive the same services from banks as the Code sections 401(a), 403(b) and 457 plans identified in proposed Rule 770.

(3) Proposed Rule 770 should be expanded to allow banks to effect plan transactions not only in mutual funds, but also in other securities, including securities issued by the employer sponsoring an employee benefit plan ("employer securities"). It is common for plan investments to include employer securities, and plan sponsors and other plan fiduciaries expect bank trustees and custodians to provide such transaction services for securities owned by plans, especially employer securities owned by plans.

(4) Finally, Proposed Rule 770 should be revised to allow banks to hold custody of securities purchased in connection with participant-directed brokerage accounts and to also provide clearance and settlement services in connection with securities transactions for participant-directed brokerage accounts. So long as participants must place their orders for securities transactions for their participant-directed brokerage accounts with a registered broker, they are afforded the protections provided by broker-dealer registration.

Bonus Programs

We continue to believe that only bonus plans that are used as an indirect conduit to pay brokerage-related compensation not covered by the networking exception should be prohibited. We note that in the Release the Commission allows bonuses that are based on the overall profitability of the bank or the overall profitability of the bank holding company as well. However, while profitability of a bank or a bank holding company may be a component of some bonus plans, in most cases it would not be the sole factor.

In addition, we believe that the bank regulators, rather than the Commission, should oversee the bonus plans of banks.

Accordingly, we ask that the Commission reconsider its position on bonus plans, or more correctly take the position that bank bonus plans are outside of their jurisdiction, except when used as an indirect conduit to pay brokerage-related compensation not covered by the networking exception.

Dual Employees

Although Rule 3040 is not directly the subject of the Proposed Rules, Mellon is concerned about its potential enforcement in the context of bank activities. The use of dual employees will, practically speaking, be necessary for most institutions to operate within the bank exceptions and to continue providing the services they now provide. However, Rule 3040 was not intended to cause the NASD to examine the activities of banks, and we continue to believe that NASD Rule 3040 should not be extended to require affiliated broker dealers utilizing dual employees to supervise otherwise exempt bank activities.

Mellon believes that NASD Rule 3040 should be amended to allow a securities firm to give blanket consent to its employees to be dual employees with the bank and provide that activities performed through the bank entity may be supervised only by managers in the bank, subject to the broker-dealer being informed if the employee engages in securities fraud in the bank.

Mellon appreciates the opportunity to comment upon these Proposed Rules. If we can be of any further assistance, please do not hesitate to call me at 412-234-1537 or William R. Nee, Associate Counsel, at 412-234-1087.

Yours sincerely,

Michael E. Bleier
General Counsel

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