<u>Bank of Montreal   Harris Bank</u>

August 31, 2004

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

Re: Proposed Regulation B Under Section 3(a)(4) of the Securities Exchange Act of 1934, Release No. 34-49879 (File No. S7-26-04) ("Proposed Regulation B")[1]

Dear Mr. Katz:

On behalf of Harris Trust and Savings Bank, The Harris Bank N.A. and our 26 community banks (collectively, "Harris"), we appreciate the opportunity to comment on Proposed Regulation B issued by the Securities and Exchange Commission ("Commission") and implementing provisions of the Gramm-Leach-Bliley Act of 1999 ("GLB Act").

Harris is part of BMO Financial Group, a Canadian organization operating in the United States ("BMO Group"). In the United States, BMO Group comprises bank and several non-bank entities, including brokerage firms, with a total of approximately $60 billion in assets under management. BMO Group offers a wide range of financial services, including trust, private banking, and investment services.

This letter addresses our general concerns with the approach the Commission has taken with Proposed Regulation B, as well as our concerns regarding the specific provisions of Proposed Regulation B. Chairman Donaldson has requested that banks provide specific, concrete numbers to support their comments to the Commission. Harris undertook an in-house effort to

[1] 69 Fed. Reg. 39682 (June 30, 2004) ("Proposing Release").

assemble such data and has provided estimates based on such data in this letter when time and available information allowed.

1. Introduction and General Concerns

Harris remains concerned that, like the prior Interim Rules that were never implemented,[2] Proposed Regulation B imposes an extremely burdensome regime of overly complex, extremely costly and unworkable requirements. We do not believe that this result was contemplated or intended by Congress, nor is it consistent with the language of the GLB Act itself. The language of the GLB Act is quite clear: It provides specific exceptions from the broker and dealer definitions of the securities laws in order to permit banks to continue to provide trust and fiduciary, safekeeping and custody, and other traditional banking products and services. In enacting these exemptions as clearly and plainly as it did, Congress recognized that banks, with the oversight of Federal and state bank examiners, have been providing these services and products effectively for decades. In the Conference Report, Congress noted that the GLB Act provides exemptions for banking activities in order to "facilitate certain activities in which banks have traditionally engaged."[3] Congress also recognized that banks have been providing these services "without any problem for years" and without supervision by securities regulators.[4]

Despite Congress' intent to leave customary bank activities undisturbed, the Commission has taken a contrary view in Proposed Regulation B. The Commission has injected restrictions and limitations on banking activities that are found nowhere in the language of the GLB Act. Indeed, concepts such as "sales compensation," "relationship compensation," and "qualified investor" are not found in the language of the statute. The restrictive approach adopted in Proposed Regulation B appears to have been designed by the Commission to regulate problems that the Commission perceives to be present in the banking industry but which neither Congress nor bank regulators nor the banks themselves believe exist.

We believe that the Commission's approach in Proposed Regulation B effectively negates the statutory exemptions found in the GLB Act and the Congressional intent underlying those exemptions. By restricting customary banking activities as it has done, the Commission has adopted a position that is fundamentally inconsistent with both the plain language of the

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[2] 66 Fed. Reg. 27759 (May 18, 2001).

[3] See H.R. Conf. Rep. No. 106-434 at 163 (1999).

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

statute and the principles that underlie it. In addition, we believe that the ultimate outcome of the Commission's position will be to eliminate choices presently available to consumers by restricting and eliminating the broad range of products and services that banks are able to offer to a wide variety of customers at differing wealth levels. This is perhaps the most unfortunate consequence of the implementation of Proposed Regulation B.

2. Trust and Fiduciary Activities Generally

The GLB Act provides a statutory exception for traditional trust and fiduciary activities of banks ("Trust and Fiduciary Exception").[5] The Trust and Fiduciary Exception authorizes a bank to effect securities transactions in a trustee or fiduciary capacity in its trust department or other department that is regularly examined by bank examiners, so long as the bank is "chiefly compensated," consistent with fiduciary principles, on the basis of an annual or administrative fee, a fee based on a percentage of assets under management, a flat or capped per order processing fee equal to not more than the cost incurred by the bank in processing the securities transaction, or any combination of these fees.[6] The Trust and Fiduciary Exception also prevents the bank from soliciting brokerage business, other than by advertising that it effects securities transactions in conjunction with advertising its other trust activities.[7]

A. Account-by-Account Exemption

Under Proposed Regulation B, Harris would be exempt from the "chiefly compensated" condition with respect to any particular account for any year it could show that: (1) it met all of the other conditions of the Trust and Fiduciary Exception, (2) it met the "chiefly compensated" condition with respect to that account in the preceding year, and (3) it has in place on-going compliance procedures reasonably designed to ensure that, for ***each*** trust and fiduciary account, it is likely to receive more "relationship compensation" than "sales compensation" at specific times during the life-cycle of the account: (i) when the account is opened, and (ii) when Harris individually negotiates with the accountholder or beneficiary to increase the proportion of sales compensation.[8]

[5] 15 U.S.C. § 78c(a)(4)(B)(ii).

[6] See id.

[7] See id.

[8] See Proposed Section 242.722, Proposing Release at 39734.

As was the case with the Interim Rules, this proposed exemption requires an account-by-account analysis that is not currently performed by Harris and will be costly and burdensome to implement. We do not believe that any account-by-account calculation is either workable or consistent with the intent and wording of the Trust and Fiduciary Exception.

As of the date of this letter Harris administers over 9,000 trust, estate and managed agency accounts nationwide.[9] Harris administers these accounts in the various capacities of trustee, executor or personal representative, guardian or conservator, agent for an executor or personal representative, custodian under the Uniform Gifts (or Transfers) to Minors Act, qualified intermediary under Section 1031 exchange trusts,[10] and investment manager. Harris does not currently act as indenture trustee and we have only a few accounts for which we act as a fiduciary under customer employee benefits plans.

Harris believes that there should be only two categories of compensation under any final rule: "sales compensation" and "non-sales compensation." This latter category would include all compensation that a bank receives with regard to its fiduciary activities that is not "sales compensation." "Non-sales compensation" that Harris receives includes, without limitation, the following:

- investment management fees;[11]
- fiduciary administration fees;[12]
- tax preparation fees;[13]

[9] We have trust offices in Illinois through Harris Trust and Savings Bank, an Illinois state bank with trust powers, and in Arizona, Washington and Florida through The Harris Bank N.A., a national bank with trust powers.

[10] These are created pursuant to Section 1031 of the Internal Revenue Code of 1986, as amended ("Tax Code"), regarding tax-deferred like-kind property exchanges. Harris charges a one-time flat fee to administer these trusts.

[11] These fees generally are charged as a percentage of assets under management. However, for some small accounts, this fee is a flat fee. The flat fee varies depending on the size of the account.

[12] These fees are primarily charged as a percentage of assets under management and may vary depending on whether co-fiduciaries are acting with Harris and whether the trust account is revocable or irrevocable. Many of our accounts are charged based on older fee schedules implemented prior to 2003. Fiduciary administration fees for these accounts are typically based on a flat rate.

[13] These fees are charged as a flat fee that varies depending on whether the trust account is revocable, irrevocable, or for a charitable trust or foundation.

- disbursement fees;[14]
- special asset fees;[15]
- estate administration and death-related duty fees;[16]
- fees for extraordinary administrative services;[17] and
- account termination fees.[18]

These fees are either administrative or annual fees that are payable from the account (or directly by the beneficiary or by the principal of the account or by another other third party[19]) or they are based on a percentage of assets under management. All such fees are incurred in the course of administering these fiduciary relationships and providing fiduciary services to our customers. By creating two distinct, exclusive categories of "compensation" the final rule will provide clarity in compliance and make calculation under any final rule easier and less costly. Therefore, we request that the Commission eliminate the concept of "unrelated compensation" and confirm, in a final rule release, that all fees are either "sales compensation" or "non-sales compensation."

[14] These are flat fees charged per disbursement to a beneficiary when disbursements exceed four per month. These are disbursements requested by beneficiaries of the trust for living expenses, medical expenses, etc.

[15] These fees generally are charged as a percentage of the value of the special asset and vary depending on whether the bank has full or shared authority or is directed. Some assets may be charged on a flat fee basis. Special asset fees are charged for administering assets such as oil, gas and mineral interests, timber, closely-held business interests, royalty interests, and residential or investment real estate.

[16] These fees are charged as a percentage of estate assets. These services may include date of death and alternate date valuation, identification of assets at death, collection of assets at death, payment of debts, claims, medical and funeral expenses, preparation of final income tax return, payment of specific bequests, determination of liquidity needs for taxes, debts and expenses, collection of life insurance proceeds, IRA and retirement plan pay-out decisions, asset allocation and funding, and preparation of Form 706 estate tax return.

[17] These fees are charged on an hourly basis depending on the level of bank employee requested to perform the service. These fees are charged for such services as identification, collection and re-registration of assets for grantors or revocable living trusts who become unable to manage their affairs, issues relative to administering a trust whose governing law is other than a state in which Harris has a trust office, statement research and retrieval, transferring title to illiquid or non-marketable assets, preparation of special reports (such as performance analysis and bond accretion), monitoring involvement in court proceedings, responding to subpoenas and preparation and participation in depositions and court hearings.

[18] These are processing fees that are charged per issue and per recipient to cover costs incurred in re-registering and distributing trust assets upon termination.

[19] In approximately 200 of our accounts, invoices are generated and fees are paid by the customer or a third party directly to the bank.

Harris also currently receives 12b-1 fees, shareholder servicing fees and soft-dollar research from third parties. Under Section 242.724 of Proposed Regulation B, "sales compensation" includes "[c]ompensation that if paid to a broker or dealer would be payment for order flow, as defined in 17 CFR 240.10b-10."[20] Such "order flow" payments would include soft-dollar research. It is our understanding that inclusion of soft-dollar research in "sales compensation" in Section 242.724 of Proposed Regulation B was not intended. Therefore, we respectfully request that soft-dollars be expressly removed from the definition of "sales compensation" in the final rule release.

Harris believes that it would meet the "chiefly compensated" condition for this exemption in virtually all of its accounts. However, Harris does not currently have software or systems in place that separate the various components of the fees it charges and track them for purposes of determining what the Commission has defined as "relationship compensation." Harris also does not have systems in place that track and allocate 12b-1 and shareholder servicing fees to the account level. Based on initial inquiries with third-party providers, we believe that a system to track various aspects of "relationship compensation" will cost approximately $700,000 initially and approximately $95,000 each year for systems support. This does not include the expense of allocating employees to implement on-going compliance procedures. We also have not yet been able to ascertain the cost of the systems needed to track and allocate to individual accounts the various payments we receive from mutual fund providers for purposes of determining "sales compensation."

B. <u>Line-of-Business Exemption to Account-by-Account Analysis</u>

Harris believes that a line-of-business exemption to the "chiefly compensated" condition would be useful if it did not require review of individual accounts at any time <u>and</u> if any compensation ratio compared "sales compensation" to the "total compensation" that an organization receives with regard to it fiduciary activities. "Total compensation" would mean the sum of "sales compensation" and "non-sales compensation." (*See* comment regarding exclusive categories of "sales compensation" and "non-sales compensation" in section 2.A. above). We believe that this would simplify the processes required to comply with this portion of Proposed Regulation B. In addition, these calculations should be permitted to include multiple banks within the same bank holding company.

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[20] <u>See</u> Proposed Section 242.724(i)(2), Proposing Release at 39735, which refers to the definition of "payment for order flow" under 17 CFR 240.10b-10.

The Commission has recognized the problems inherent in the account-by-account calculation and has provided this line-of-business exemption. Under this alternative exemption, Harris would be permitted for any year to meet the "chiefly compensated" test on a "line-of-business" basis if it could show that the ratio of "sales compensation" to "relationship compensation" from all trust and fiduciary accounts within a particular line of business was no more than one to nine.[21] To use this exemption, Harris also must comply with all other conditions of the Trust and Fiduciary Exception and must have in place on going compliance procedures reasonably designed to ensure that, for ***each*** trust and fiduciary account, it is likely to receive more "relationship compensation" than "sales compensation" at specific times during the life-cycle of the account: (1) when the account is opened, and (2) when Harris individually negotiates with the accountholder or beneficiary to increase the proportion of sales compensation.[22]

While Harris supports the Commission's view that the "chiefly compensated" analysis should occur at a higher level than the individual account level, we see no significant advantages to using the proposed line-of-business exemption. This alternative calculation method is conditioned on having so many procedures in place– ***procedures that involve the very account-by-account monitoring (and attendant costs) that the exemption purports to avoid*** – that Harris believes it is rendered virtually useless. Moreover, the one-to-nine ratio requirements of this so-called exemption (as well as the one-to-seven ratio requirements of the so-called safe harbor[23]) are more arduous to navigate and much stricter than the "account-by-account" exemption, which would require Harris to demonstrate that it is "likely to receive more relationship compensation than sales compensation with respect to that account."[24] The requirements of this line-of-business exemption are certainly much stricter than the plain language of the GLB Act itself.

We have attempted to run preliminary calculations across our charters[25] to estimate whether Harris would fall within the one-to-nine ratio requirement of this exemption. In so

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[21] See Proposed Section 242.721, Proposing Release at 39734.

[22] See id.

[23] See id.

[24] See Proposed Section 242.722, Proposing Release at 39734.

[25] Our trust offices within Illinois are housed within Harris Trust and Savings Bank, a state-chartered institution. Our trust offices outside of Illinois are housed in The Harris Bank N.A. However, they all ultimately report to the same bank executives and are considered one line of business for revenue reporting purposes.

doing, we developed a number of interpretive questions (such as whether trust termination fees are "relationship compensation" and how to allocate soft-dollar research) and encountered several systems limitations. Nevertheless, based on our best efforts, we believe that the "sales compensation" that Harris receives is within the one-to-nine ratio when calculated against total trust department revenue.[26]

As noted above, our preliminary calculations were run on a line-of-business basis that spans two bank charters within the same bank holding company. Currently, Harris' trust, estate and managed agency activities are housed within one internal line of business that spans two separate bank charters held by the same bank holding company. Regardless of the separate legal entities, the trust and fiduciary activities that take place within these two banks are internally operated as one line of business.[27] Therefore, Harris respectfully requests that the Commission permit the "chiefly compensated" calculations of the line of business exemption to be performed across multiple banks within the same bank holding company.

C. Exemption for Existing Living, Testamentary or Charitable Trusts

The Commission has proposed an additional exemption from meeting the "chiefly compensated" condition on an account-by-account basis for all living, testamentary or charitable accounts opened or established before July 30, 2004, so long as (1) there is no individual negotiation with the accountholder or beneficiary to increase sales compensation after that date, and (2) all other conditions of the Trust and Fiduciary Exception are met.[28]

Harris agrees with the Commission that a grandfathering provision for personal trust accounts is useful. However, we do not believe that the exemption should be limited only to living, testamentary and charitable trusts. "Living trust" is a term of art in the estate planning community and refers only to revocable trusts established during the settlor's lifetime. Harris believes that <u>all</u> personal trusts, whether created during a settlor's lifetime or at death, and

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[26] The total trust department revenue numbers that we used in our calculations included 12b-1 and shareholder servicing fees. We were not able easily to separate out these fees and "unrelated compensation" items, such as tax preparation fees, from our total compensation numbers. At this time, we simply do not track individual components of the fees we receive from customers and/or their accounts separately.

[27] As noted previously in this letter, Harris does not currently have corporate trust or employee benefits lines-of-business.

[28] <u>See</u> Proposed Section 242.720, Proposing Release at 39733.

whether revocable or irrevocable, should be included. This would include, by way of example and in addition to revocable "living trusts":

- irrevocable life insurance trusts;
- individual retirement trusts;
- OBRA trusts;[29]
- special needs trusts;
- Section 2503(c) and Section 2503(b) gift trusts;[30]
- generation-skipping transfer tax dynasty trusts;[31]
- charitable remainder trusts;[32]
- charitable lead trusts;
- perpetual charitable trusts;
- like-kind exchange or Starker trusts;[33]
- qualified domestic trusts;[34]
- marital trusts (including general power of appointment marital trusts and qualified terminable interest marital trusts);[35]
- credit shelter or "family trusts;" [36]
- qualified personal residence trusts;[37] and

[29] These are trusts created pursuant to the Omnibus Budget and Reconciliation Act of 1993. See 42 U.S.C. § 1396p et seq.

[30] These are trusts created pursuant to Sections 2503(c) and 2503(b) of the Tax Code.

[31] These are trusts that are exempt from generation-skipping transfer taxes pursuant to Section 2601 et seq. of the Tax Code.

[32] These are trusts that qualify under Section 664 of the Tax Code.

[33] These are created pursuant to Section 1031 of the Tax Code regarding tax-deferred like-kind property exchanges.

[34] Qualified domestic trusts are created pursuant to Section 2056A of the Tax Code for the benefit of non-citizen spouses in order to qualify trust assets for the marital deduction.

[35] General power of appointment marital trusts are created pursuant to Section 2056(b)(5) of the Tax Code. Qualified terminable interest marital trusts are created pursuant to Section 2056(b)(7) of the Tax Code. Both are created to qualify trust assets for the unlimited estate tax marital deduction.

[36] These are trusts created at death to hold the decedent's available applicable exclusion amount under Section 2010 of the Tax Code.

- grantor retained annuity or unitrusts.[38]

All estate, guardian and conservator accounts should be included. Moreover, any personal trust account created from a grandfathered account should be included. For example, if a settlor creates a revocable "living trust" during her lifetime that is grandfathered under Proposed Regulation B, at the settlor's death, and under the terms of the governing instrument, the trust assets may divide into several more trusts pursuant to the estate plan, such as a generation-skipping dynasty trust, a qualified terminable interest marital trust for the surviving spouse, and a credit shelter trust. Further, at the surviving spouse's death, some of these trusts may terminate but more may be created from those same assets (such as continuing trusts for then living children) by way of the exercise of the surviving spouse's testamentary power of appointment or pursuant to the default provisions of the original governing instrument. All of these trusts should be grandfathered for purposes of Proposed Regulation B. To do otherwise would require that we track on an on-going basis our grandfathered personal trusts, which is the very thing that this proposed exemption purports to avoid.

Also, Harris asks for clarification regarding Section 242.720(b) of Proposed Regulation B which provides that "a testamentary trust may be deemed to be established as of the date of the will that directed that the trust be established."[39] Does this mean, for example, that a testamentary trust that actually comes into existence when a testator dies on December 1, 2008, is grandfathered if the will was signed on or before July 30, 2004? What would be the result if the testator merely executed a codicil to the will after July 30, 2004? What would be the result if, once the testamentary trust was created in 2008, the assets are moved by the trust beneficiaries to a new institution (this question also would apply to any trust account, whether testamentary or created during the settlor's lifetime, that moves to a different financial institution after July 30, 2004)?

Further, Harris Trust and Savings Bank questions the viability of the grandfathering provision in the case of totally internal and merely re-organizational bank mergers: Harris Trust

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[37] These are trusts created pursuant to Section 2702(a) of the Tax Code whereby the settlor transfers her personal residence (and cash as permitted) to a trust for maximum gift and estate tax savings.

[38] These are trusts created pursuant to Section 2702(a) of the Tax Code. Individuals create these trusts using assets that are likely to earn more than the Internal Revenue Service's measuring standard (the Section 7520 interest rate) during the term of the trust in an effort to pass the appreciation in the assets to the beneficiaries of the trust free of gift and estate tax.

[39] See Proposed Section 242.720(b), Proposing Release at 39734.

and Savings Bank intends in 2005 to merge with its community banks in Illinois and convert its Illinois state banking charter to a national banking charter. It is our understanding that the Commission has taken the position that accounts moved by way of acquisition or other internal reorganization will lose their grandfathered status. Is it the case, then, that all of Harris' grandfathered accounts will lose their grandfathered status in 2005 when we consolidate our charters? We respectfully request that the Commission reconsider its position on this issue and confirm that such accounts will **not** lose their grandfathered status as a result of any merger, acquisition or other internal corporate reorganization or internal movement of accounts for any reason. Once an account is grandfathered it should remain that way in order to provide banks some certainty and clarity going forward.

Moreover, Harris respectfully requests that the Commission consider including investment management accounts in the grandfathering provisions and extending the grandfather-date to the date the final regulations go into effect.

D. Investment Advice for a Fee

The GLB Act provides that a bank will be protected by the Trust and Fiduciary Exception if it provides investment advice for a fee.[40] Specifically, under Proposed Regulation B, the Trust and Fiduciary Exception will be available to a bank acting as an investment adviser only if the bank has a relationship with the customer in which, (1) the bank owes the customer a duty of loyalty, including an affirmative duty to make full and fair disclosure of all material facts and conflicts of interest, and (2) the bank has an ongoing responsibility to provide investment advice based upon the customer's individual needs that includes selecting or making recommendations regarding specific securities and a responsibility to direct approved purchases and sales to a registered broker or dealer.[41] Harris believes that these additional requirements have no basis in and are more restrictive than the language of the GLB Act.

The Commission has stated that a bank providing general asset allocation advice <u>not related to specific securities</u> cannot rely on the Trust and Fiduciary Exception.[42] However, in the Commission staff's interpretation of the definition of "investment adviser" under the Investment Advisers Act of 1940 ("Advisers Act"), the Commission has maintained that "investment

[40] 15 U.S.C. § 78c(a)(4)(D)(i).

[41] <u>See</u> Proposed Section 242.724(d), Proposing Release at 39735.

[42] <u>See</u> Proposing Release at 39702.

advice" includes issuing or promulgating reports or analyses, which concern securities, but which do not relate to specific securities.[43] In addition, the Commission's staff has stated that investment advice may include advising clients concerning the relative advantages and disadvantages of investing in securities in general as compared to other investments.[44] It also includes, in the course of developing a financial plan for a client, advising him or her as to the desirability of investing in, purchasing or selling securities, as opposed to, or in relation to, any non-securities investment or financial vehicle.[45] A person providing advice to a client as to the selection or retention of an investment manager or managers also may be deemed to be providing investment advice.[46] "Investment advice," as used in the GLB Act, offers no basis for interpreting that phrase any more narrowly than the Commission staff's existing interpretation of what "investment advice" means under the Advisers Act.

The Commission's position in Proposed Regulation B would appear to affect Harris' ability to offer separate account and "open-architecture" products to our customers. In these situations, the bank chooses investment managers and delegates investment management functions to those managers; however, the bank continues to provide investment advice to the customer for a fee but does not select or manage specific securities held in the account. We believe that the term "investment advice" in the GLB Act comprehends such services and we respectfully request clarification from the Commission on this point.[47]

The Commission has stated in a footnote that banks seeking to rely on the Trust and Fiduciary Exception for investment advisory activities will be expected to be in compliance with the disclosure requirements applicable to investment advisers under the Advisers Act.[48] Harris respectfully requests further clarification from the Commission on this point. Nowhere in the GLB Act is there any indication of Congressional intent to apply the disclosure provisions of the Advisers Act to the investment advisory activities of banks, activities that are fully reviewed and examined by bank regulators and already governed by state and federal law.

[43] See SEC Release 1A-1092 (Oct. 8, 1987).

[44] See id.

[45] See id.

[46] See id.

[47] See 12 CFR 9.2(i) ("A bank that delegates its authority over investments . . . [is] deemed to have investment discretion.")

[48] See Proposing Release at 39703 n. 190.

E. Regularly Examined by Bank Examiners for Compliance with Fiduciary Principles

The GLB Act requires that all securities transactions effected by a bank under the Trust and Fiduciary Exception be effected in the bank's trust department or in another department of the bank that is regularly examined by bank examiners for compliance with fiduciary principles and standards.[49] The Commission proposes to interpret that language to require that "all aspects" of the securities transactions conducted by a bank for its trust and fiduciary customers be regularly examined by bank examiners for compliance with fiduciary principles and standards.[50]

Harris agrees with the Commission that it is important to preserve the ability of banks to hire affiliates and third-party service providers to conduct back office functions, including securities-related functions. We understand that the Commission's proposed interpretation would permit Harris to outsource its trust operations, including securities-related functions, only to a third party broker-dealer or another bank or a registered investment adviser.[51] We believe that this interpretation is overly restrictive. There is nothing in the GLB Act that would authorize the Commission to restrict or to regulate banks' reliance on third-party providers to provide trust and fiduciary services.

3. <u>Safekeeping and Custody Exception</u>

At Harris, we have provided our customers with custody and safekeeping services for decades. In our Private Bank, these services include order-taking from custodial and safekeeping customers.[52] Order-taking is a customary and necessary part of Harris' custodial

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[49] 15 U.S.C. § 78c(a)(4)(B)(ii).

[50] <u>See</u> Proposing Release at 39703.

[51] <u>See</u> <u>id</u>. at 39704.

[52] Harris' private banking custody accounts are more customized than typical brokerage accounts and assets in our custody accounts are not subject to margin calls, as is the case with brokerage accounts. In addition to order taking, Harris also provides the following services to custodial customers: income and principal accountings; direct bill-pay; direct payment of quarterly income tax installments; safekeeping securities; payment or reinvestment of cash balances as directed; processing corporate actions; collecting dividends, interest and other income; automatic reinvestment of cash balances; settling trades; year-end tax reporting; and maintaining cost records and preparing annual gain/loss summary at customer's request. Typically, annual charges for these services consist of a fee based on the market value of, and transactions and

services, which are also one of the primary ways in which we establish initial customer relationships that may evolve into investment management and personal trust services in the future.

Recognizing this, Congress has expressly permitted banks to continue to engage in a variety of their customary custodial and safekeeping activities without being considered brokers ("Custody Exception"). Indeed, the GLB Act contemplates that, in connection with providing these customary services, banks will continue to be involved in order-taking, which is why the GLB Act requires banks that wish to take advantage of the Custody Exception to direct orders to a broker for execution.[53] If Congress had intended for banks merely to deliver securities or cash, then there would be no need for the statute's broker execution requirement.

The Commission has determined that, after July 30, 2004, in order for a bank to rely upon the Custody Exception and continue order-taking services, all new custody and safekeeping customers must be "qualified investors".[54] The "qualified investor" restriction is not found in the language of the GLB Act and is, we believe, contrary to Congress' intent to permit banks to continue to engage in a variety of their customary custodial and safekeeping activities. This new restriction will have a major impact on Harris' ability to attract private banking custody customers in the future. We therefore respectfully request that the Commission reconsider its position on this matter.

We believe that the majority of Harris' current private banking custody customers are not qualified investors. As of the date of this letter, Harris administers approximately 700 custody accounts in its Private Bank. These customers are primarily individuals and individual trustees who have larger trust or investment management relationships with Harris. Many of these relationships exceed $25,000,000 in total; however, individual custodial account owners may not meet the qualified investor threshold. These customers (particularly individuals acting as trustees) prefer Harris as their custodian because of the services we provide that brokers do not, such as income and principal accountings and bill paying capabilities. They also prefer to have all of their financial services accounts administered at the same institution as part of one relationship. The Commission's new restrictions will effectively eliminate customer choice,

disbursements made within, an account. For some small accounts, fees may be charged on a flat rate. This flat rate varies depending on the size of the account.

[53] 15 U.S.C. § 78c(a)(4)(C).

[54] See Proposed Section 242.760, Proposing Release at 39736.

particularly for those customers who are not qualified investors, by effectively requiring that banks "push-out" this business to brokers.

Harris also has institutional custody and safekeeping departments. Our institutional custody department currently administers over 150 accounts and has custody of more than $11 billion of customer assets. Some of these customers are not qualified investors.[55] Our safekeeping department currently administers approximately 450 retail accounts and 3000 corporate accounts. Its account base includes customers such as correspondent banks, large corporate customers, clearing corporations, and exchanges. Our safekeeping department holds approximately $52 billion in customer securities. Generally, our institutional custody and safekeeping units are not involved in order-taking. However, our institutional custody area does accommodate its charitable foundation customers who receive stock donations by accepting orders from these customers to sell these stock donations. They also will accept orders for mutual fund transactions.[56] We believe that these are valuable accommodations to our institutional customers, whether they be qualified investors or not, and should continue to be permitted.

Proposed Regulation B also provides that banks may continue to take orders for qualified investors if they can demonstrate that they do not charge, or receive for effecting such transactions, any compensation that directly or indirectly varies based on whether the bank accepts an order to purchase or sell a security (other than 12b-1 fees and certain fees paid by mutual fund companies).[57] Therefore, it would seem that if a bank receives asset management fees only, it could continue to take orders for qualified investors, so long as the other requirements of Section 242.760 are met.[58] Harris respectfully requests confirmation from the Commission on this point.

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[55] Our institutional custody and safekeeping customers are composed of hospitals, religious orders, foundations, insurance companies, educational institutions, endowments and other not-for-profits.

[56] Other services include: account administration (direct client contact and service responsibilities); security safekeeping; trade settlement; income collection; mutual fund processing; free deposit and delivery of securities; corporate action notification; portfolio administration (investment manager relations); financial reporting; cash processing (including, account transfers, wires and check production); legal files (control of client agreements and related documents); asset file maintenance (including security set-up, rate and pricing updates); and overnight cash sweep.

[57] See Proposed Section 242.760(a)(1), Proposing Release at 39736.

[58] Even Proposed Regulation B contemplates that order taking may continue as long as a bank custodian does not directly charge for this service. See id.

The Commission is also proposing to define the term "account for which the bank acts as custodian."[59] Pursuant to this definition, a custody account must be 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."[60] This proposed definition may require banks to re-document each of their custody relationships. For example, if a custody agreement refers to a bank's published fee schedule, rather than describing the specific fees payable in the agreement itself, is the custody agreement insufficient under Proposed Regulation B? Harris sees no purpose for the quoted language and requests that the Commission eliminate it in the final rule release.

Harris also requests clarification regarding the solicitation restrictions of Section 242.760(a)(3). If a bank's trust department sends out marketing information that complies with the Trust and Fiduciary Exception by advertising that it effects transactions in securities in conjunction with advertising its other trust activities, would this violate Section 242.760(a)(3)? We are concerned that Section 242.760(a)(3) is written so broadly that permissible marketing material sent by other areas of the bank may force the bank out of compliance with the Custody Exception.

As with Section 242.720 of Proposed Regulation B noted above, Harris urges the Commission to extend the grandfathering date for safekeeping and custody accounts to the date the final regulations go into effect.

4. <u>Networking Exception</u>

The GLB Act permits banks to enter into arrangements with broker-dealers to offer brokerage services to bank customers, provided that the arrangement meets certain requirements specified in the GLB Act ("Networking Exception").[61] Proposed Regulation B has injected even more uncertainty in the area of bank employee bonus programs, which is an area that we do not believe the Commission is mandated to regulate. We respectfully request further clarification in this area and ask the Commission to reconsider its position.

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[59] <u>See</u> Proposed Section 762(a), Proposing Release at 39737.

[60] <u>See</u> <u>id</u>.

[61] 15 U.S.C. § 78c(a)(4)(B)(i).

On the one hand, the Commission has previously stated that transaction-related incentive payments between a broker and a bank are permitted.[62] Therefore, Harris' affiliated broker may make incentive payments to the bank without limitations. On the other hand, in Proposed Regulation B, the Commission has broadly interpreted the meaning of "one-time fixed dollar amount" to prohibit bonus payments to any employee of the bank that are based, directly or indirectly, on a referral for which the an employee has received a referral fee.[63] This would appear to mean that any incentive payment from Harris' affiliated broker to the bank may taint Harris' entire bonus program. We strongly disagree with this result as being completely unworkable and ask the Commission for clarification.

The Commission maintains the position in Proposed Regulation B that bonus programs based on the performance of a branch, department or line of business within a bank are unacceptable.[64] Harris disagrees with the Commission on this point. We fail to see how a unit-, team- or line of business-based bonus program that specifically weights brokerage products no higher than any of the organization's other products would promote an inappropriate "salesman's stake" in brokerage products among our employees. Our employees have a stake in the success of all of our organization's products. By regulating our bonus programs, the Commission is limiting our ability to reward our employees for their participation in the success of any combination of our products. We also fail to see how this type of bonus program violates either the language or intent of the GLB Act.

Similarly, Harris believes that relationship-based bonus programs or programs that include a relationship-based component should be permissible under Proposed Regulation B. This type of program would reward bank employees with regard to the overall customer relationships for which they are involved, based on "relationship-oriented" factors such as retention of customer accounts, increased value of customer accounts, and increased number and type of accounts that a customer maintains with the entire Harris organization. All accounts that a customer may have or may open with entities within the Harris organization would be included, including brokerage accounts. Bank employees would be rewarded based on the total growth and maintenance of the customer relationship as evidenced by these various factors. These factors may be weighted, but brokerage business would not be weighted higher than other products. We do not believe that this type of relationship-based bonus program violates the

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[62] See 66 Fed. Reg. 27759 at 27766 (May 18, 2001).

[63] See Proposing Release at 39690.

[64] See id (ft. nt. 62).

language and intent of the GLB Act, nor would it promote an inappropriate "salesman's stake" in brokerage products among bank employees. Harris respectfully requests clarification from the Commission on this point.

5. Applicability of NASD Rule 3040

While the Commission has deleted Interim Rules 3a4-5(a)(2)(i) and (iii),[65] the applicability of NASD Rule 3040 to dual-employee arrangements in which bank employees also are employees of a broker-dealer has not yet been addressed. Harris may rely on dual-employee relationships to comply with many of the exceptions under the GLB Act. Application of Rule 3040 to our bank employees who also are employees of our affiliated broker-dealer would require security transactions made by the employee in her capacity as bank employee to be (1) approved by the broker-dealer and (2) recorded on the broker-dealer's books and records.[66] Accordingly, each separate transaction must be approved and monitored by the broker-dealer, and the funds for the transaction must be transferred to the books and records of the broker-dealer. As a result of this regulatory burden, Harris may have no choice but to "push-out" all securities transactions to the broker-dealer. This would effectively deny Harris the benefits of the exceptions provided by the GLB Act, and would most definitely be contrary to Congressional intent.

Harris strongly urges the Commission to provide clarity in this area by assisting in obtaining an amendment to NASD Rule 3040 that specifically states that the Rule does not apply to dual employees operating in their capacities as bank employees. Harris also urges the Commission to delay the effective date of Proposed Regulation B until Rule 3040 has been amended.

Conclusion

Harris believes that the Commission's Proposed Regulation B imposes unnecessarily burdensome and costly requirements that will disrupt the bank's existing customer relationships and could force the bank to discontinue offering traditional products and services, a result that Congress specifically sought to avoid. Given the magnitude of the impact that these rules will have on the core of Harris' banking business and trust operations, we respectfully request that the Commission revise its rules considering the foregoing comments and provide clarification as requested herein.

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[65] See Proposing Release at 39732.

[66] See NASD Rule 3040.

Sincerely,

/s/

Paul V. Reagan
Executive Vice President and U.S. General Counsel

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