The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 20878

February 16, 2007

ICI Draft Comment Letter on Proposed Regulation R That Would Define When a Bank is a Broker-Dealer Under the 1934 Act

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TO: BANK, TRUST AND RECORDKEEPER ADVISORY COMMITTEE No. 6-07
BANK INVESTMENT MANAGEMENT MEMBERS No. 1-07 RE: ICI DRAFT COMMENT LETTER ON PROPOSED REGULATION R THAT WOULD DEFINE WHEN A BANK IS A BROKER-DEALER UNDER THE 1934 ACT

As jointly proposed by the Federal Reserve Bank and the Securities and Exchange Commission last December, Regulation R would implement the functional regulation provisions of the Gramm-Leach-Bliley Act. [1] These provisions are intended to distinguish traditional banking activities from bank-brokerage activities and subject banks that engage in the latter to regulation as brokers under the Securities Exchange Act of 1934. For the most part, the proposed regulations will impact banks rather than the mutual fund firms with which they effect trades. There is, however, an issue raised by the proposal that the Institute recommends be revised to reflect current business practices. This issue is the basis for the Institute's draft comment letter, which is attached and briefly summarized below.

Members with comments on the Institute's draft letter should provide them to the undersigned by phone (202-326-5825) or email (tamara@ici.org) no later than Thursday, March 8th.

Proposed Rule 721 in Regulation R would permit a bank, under certain conditions, to effect securities transactions in a trustee or fiduciary capacity without being registered under the Act as a broker. One of these conditions is that the bank be "chiefly compensated" for its trust and fiduciary transactions on the basis of an administration or annual fee, a percentage of assets under management, a flat or capped per-order processing fee that does not exceed the bank's cost in executing the transaction, or any combination of these fees. Proposed Rule 721 defines the types of fees a bank may receive under the Act's "chiefly compensated" test as "relationship compensation," which is limited to a fee "paid by an investment company" for personal service, the maintenance of shareholder accounts, or other services listed in the rule. The Institute's comment letter notes that the fees paid to a bank for these activities are typically paid by a fund's administrator, transfer agent, primary distributor, or investment adviser, rather than the fund. Accordingly, the Institute's letter recommends that Rule 721 be revised to expand the list of entities that may pay the relationship compensation to the bank for providing the permitted services. As noted in the letter, this recommendation would reflect long-standing business practices without expanding the amount of relationship compensation the bank could receive nor the services for which it may receive such compensation.

Tamara K. Salmon
Senior Associate Counsel

Attachment

[1] *See* Institute Memorandum to Bank, Trust and Recordkeeper Advisory Committee No. 37-06 and to Bank Investment Management Members No. 1-06 [No. 20709], dated December 20, 2006.