The Asset Management Industry
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SEC'S INTERIM FINAL RULES RELATING TO THE REGULATION OF BANKS AS BROKER-DEALERS INCLUDES PROVISIONS IMPACTING TRUSTEES

[13567] May 31, 2001 TO: PENSION COMMITTEE No. 34-01 RE: SEC'S INTERIM FINAL RULES RELATING TO THE REGULATION OF BANKS AS BROKER-DEALERS INCLUDES PROVISIONS IMPACTING TRUSTEES Effective May 11, 2001, the Securities and Exchange Commission adopted on an interim final basis a variety of rules to implement provisions in the Gramm-Leach-Bliley Act (the "GLB Act") that provide functional exceptions for banks from the definitions of "broker" and "dealer" under the Securities Exchange Act of 1934 (the "Exchange Act") and to provide additional exemptions.1 These rules were adopted in response to questions from banks regarding the interpretation of these new exceptions. In addition to adopting these rules on an interim basis, the Commission has requested comment on them. While the rules cover a variety of issues, of particular interest to pension plans and IRAs may be the provisions of Rule 3b-17(k), which relate to the exemption provided in Section 3(a)(4)(B)(ii) for banks that engage in specified trust and fiduciary activities.2 In particular, Section 3(a)(4)(B)(ii) of the Exchange Act provides an exception from the definition of "broker" for banks that act as trustees or fiduciaries provided that the bank effects transactions in a trustee or fiduciary capacity, does not publicly solicit brokerage business, and complies with conditions relating to where within the bank the transaction is effected and how the bank is "chiefly compensated" for these transactions.3 According to the Release, the law is unclear as to 1 See Release No. 34-44291 (May 11, 2001)(the "Release"), 66 FED. REG. 27,759 (May 18, 2001). Cites to the Release in this memo are to the version available on the SEC's web site at www.sec.gov. Effective May 12, 2001, Sections 201 and 202 of the GLB Act substantially amended the Exchange Act's definitions of "broker" and "dealer," respectively. Prior to these amendments, these terms did not include banks. Accordingly, banks that engaged in securities activities were not required to register under the Exchange Act as brokers or dealers. The interim rules were necessitated by amendments in the GLB Act to the Exchange Act that repealed the blanket exclusion for banks from the definitions of "broker" and "dealer" and replaced it with functional exceptions that were more narrowly tailored to ensure that investors purchasing securities through a bank receive the same protections as those who purchase through registered broker-dealers. In particular, the blanket exclusions were replaced with eleven exceptions for banks from the definition of "broker," four from the definition of "dealer," and three from both definitions. 2 For a more detailed summary of all of the provisions in the SEC's Release, see Memorandum to Bank Investment Management Members No. 2-01 (May 30, 2001), which is available on the Institute's

members web site. 3 According to the Exchange Act, the bank must be “chiefly compensated” on the basis of an administration or annual fee, a percentage of assets under management, or 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 trustee and fiduciary customers,” or any combination of such fees. See Section 3(a)(4)(B)(ii) of the Exchange Act. In the Release’s 2whether banks acting in the following three capacities should be covered by this exception in the Exchange Act: indenture trustees, ERISA trustees, and IRA trustees. The Commission has resolved this uncertainty through Rule 3b-17(k), which defines the term “trustee capacity” as used in the Exchange Act to include “an indenture trustee or a trustee for a tax-deferred account described in Sections 401(a), 408, and 408A under subchapter D and in Section 457 under subchapter E of the Internal Revenue Code.”4 As such, according to the Release, the trust and fiduciary exception in Act does include trust indenture trustees and trustees for certain tax-deferred accounts (including ERISA and IRA accounts) provided that such activities are conducted in accordance with all of the other terms of the exception for trustee activities, summarized above.5 Accordingly, banks that engage in these activities subject to the conditions set forth in the Exchange Act will be able to continue to effect securities transactions without having to register as a broker. The Release expressly states, however, that the trust and fiduciaries activities exception “does not extend to securities activities that a bank transfer agent conducts with the shareholders of an issuer that resemble those of a broker-dealer.” 6 Comments on the rules, which are summarized below, must be filed with the Commission no later than July 17, 2001. The Institute plans to comment on the rules only to the extent that they impact investment companies. Persons with comments relating to the rules’ impact on investment companies should provide them to the undersigned by phone (202-326-5825), fax (202-326-5839) or e-mail (tamara@ici.org) no later than Tuesday, July 3rd. A copy of the Commission’s Release, which runs 109 pages, is available on the Institute’s member web site and on the Commission’s web site (www.sec.gov). Tamara K. Reed Associate Counsel discussion of this provision, it notes that “brokerage commissions paid to execute trust and fiduciary transactions would not fall within the ‘flat or capped per order processing fee’ definition if they result in cash rebates or soft dollar benefits to the bank other than for brokerage, research, or expenses covered by this definition. Soft dollar benefits are, on their face, more than the cost of executing a trade.” See Release at p. 25. See, also, the discussion of “service fees” in connection with this issue on pp. 26-27 of the Release and in footnote 146. 4 Footnote 85 to the Release states as follows concerning this exception: “It is important to note that our definitional exemption regarding the term ‘trustee capacity’ in Section 3(a)(4)(B)(ii) of the Act does not alter our view that Section 3(c)(3) of the Investment Company Act of 1940 is unavailable to common trust funds holding IRA assets. . . . The [GLB Act codified] our longstanding interpretation that the common trust fund exception is unavailable to common trust funds holding IRA assets because such assets are not held ‘for a fiduciary purpose.’” 5 See Release at pp. 16-17. 6 The Commission reaches this conclusion by considering the trust and fiduciary activities exception together with the definition of “transfer agent” in Section 3(a)(25) of the Exchange Act. See Release at p. 18.