U.S. Securities and Exchange Commission

SEC Votes for Final Rules Defining How Banks Can Be Securities Brokers

Eight Years After Passage of the Gramm-Leach-Bliley Act, Key Provisions Will Now Be Implemented

FOR IMMEDIATE RELEASE
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Washington, D.C., Sept. 19, 2007 - Ending eight years of stalled negotiations and impasse, the Commission today voted to adopt, jointly with the Board of Governors of the Federal Reserve System (Board), new rules that will finally implement the bank broker provisions of the Gramm-Leach-Bliley Act of 1999. The Board will consider these final rules at its Sept. 24, 2007 meeting. The Commission and the Board consulted with and sought the concurrence of the Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, and Office of Thrift Supervision.

In addition, the Commission also voted to issue a second release concerning certain bank dealer activities and other related matters.

"A customer should be able to walk into a financial institution and get any financial product he or she needs — securities, insurance, banking or trust services," said SEC Chairman Christopher Cox. "But Congress recognized those benefits couldn't be achieved without new ways to safeguard investors that would be consistent with continued innovation. Today's historic action, coming eight years after the passage of the law, is long overdue but welcome news for investors who will now begin to see the benefits of broader services and lower costs that the law intended."

An important provision of the Gramm-Leach-Bliley Act amended the definition of "broker" in the Securities Exchange Act of 1934 so that banks would no longer be completely excluded from the broker-dealer registration requirements. At the same time, the new law created specific exceptions from those requirements. Proposed Regulation R would give effect to these bank broker exceptions, in a way that accommodates the traditional business practices of banks, and at the same time furthers our goal of better protecting investors.

One of the major promises of the Gramm-Leach-Bliley Act is to stimulate greater competition in the financial services industry, and give investors a wider array of services at lower prices. Much of that has occurred, but not as much as was expected, in part due to ambiguity in the governing legal rules.

Today's action is especially important to help bring the legislative promise of the Gramm-Leach-Bliley Act to fulfillment.

The rule-writing process that culminated today in the Commission's vote of final approval has been an arduous one. After a series of interim proposals and regulatory actions that proved mostly fruitless between 1999 and 2005, the SEC made a fresh start 18 months ago. Chairman Cox convened a series of meetings that included the Board, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision, and together the agencies hammered out the final rules that the Commission approved today.

The Gramm-Leach-Bliley Act was signed into law by President Bill Clinton on Nov. 12, 1999. The Act provided an 18-month deadline for the adoption of implementing rules, but from 1999 until 2005, the rule-writing effort stalled repeatedly. On Oct. 13, 2006, President Bush signed into law the Regulatory Relief Act, which added the requirement that the Commission and the Board issue the proposed rules jointly, and seek the concurrence of the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and the Federal Deposit Insurance Corporation.

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Key Provisions of the Joint Rules

The rules define statutory terms, and provide banks with exemptions from broker-dealer registration for limited bank securities activities. In addition, the rules provide an exemption from possible third-party rescission rights when a bank acts as an unregistered broker. The following is a detailed description of these provisions of Regulation R.

Networking Exception. The networking exception allows banks to receive compensation for referring bank customers to broker-dealers. The Exchange Act provides that banks may pay unregistered employees "nominal" incentive compensation for making these referrals. The rules define "nominal," "incentive compensation," and certain other terms. The "incentive compensation" definition in the final rule and the accompanying discussion were revised to better accommodate typical bank bonus programs while also clarifying the types of bonus plans that do not constitute "incentive compensation" and therefore can be freely used. The final rules also will clarify that more than one bank employee may receive payment for a single referral as long as the payments only go to employees personally involved in the referral. The final rules also allow banks to pay more than nominal fees for referrals of certain institutional customers and high net worth customers to a broker or dealer, if the bank and broker-dealer satisfy certain conditions to protect these customers. An "institutional customer" is defined to mean an entity that has, or is controlled by an entity that has, at least (i) $10 million in investments; or (ii) $20 million in revenues; or (iii) $15 million in revenues if the bank employee refers the customer to the broker-dealer for investment banking services. A "high net worth customer" is defined as a natural person who, either individually or with his or her spouse, has at least $5 million in net worth excluding the primary residence and associated liabilities of the person and, if applicable, his or her spouse. The definition also includes any revocable, inter vivos or living trust the settlor of which is a natural person who, either individually or jointly with his or her spouse, meets the $5 million in net worth test.

Trust and Fiduciary Activities Exception. The trust and fiduciary activities exception permits a bank to effect securities transactions in a trustee or fiduciary capacity if it is "chiefly compensated" for those transactions, consistent with fiduciary principles and standards, on the basis of specifically enumerated types of fees. The rules refer to these fees collectively as "relationship compensation." These fees may be considered "relationship compensation" even if paid by a service provider rather than directly by an investment company.

The rules establish a test to determine how a bank is "chiefly compensated," and permit a bank to choose either an account-by-account or bank-wide approach. Either alternative uses a two-year rolling average comparison of the fees from the account and allows banks to exclude the compensation associated with a securities transaction conducted in accordance with any of the other exceptions or exemptions as long as the bank excludes that compensation from both relationship compensation (if applicable) and total compensation. The revenues of certain foreign branches of U.S. banks are excluded for purposes of the "chiefly compensated" test.

Sweep Accounts and Transactions in Money Market Funds. The sweep accounts exception permits a bank to sweep deposits into no-load, money market funds. The rules define terms used in the sweep accounts exception, and provide banks with a conditional exemption for transactions in money market funds that are not no-load as well as for transactions that are not sweeps. A bank relying on this exemption for transactions involving funds that are not no-load will have to provide the customer with a prospectus showing the fund's fees, and could not characterize the fund shares as no-load. This final rule also will permit a bank to effect transactions under the exemption on behalf of another bank as part of a program for the investment or reinvestment of the deposit funds of, or collected by, the other bank.

Safekeeping and Custody. The safekeeping and custody exception permits banks to perform specified services in connection with safekeeping and custody of securities. Under the exemption, banks can take orders for securities transactions from employee benefit plan accounts and individual retirement and similar accounts for which the bank acts as a custodian, as well as from other safekeeping and custody accounts on an accommodation basis. If a bank accepts securities orders under the exemption with respect to a custody account, no bank employee may receive compensation from the bank, the executing broker or dealer, or any other person that is based on whether a securities transaction is executed for the account, or on the quantity, price, or identity of the securities purchased or sold by the account.

Additional conditions will apply when a bank accepts securities orders for a custodial account on an accommodation basis. In particular, the bank can not advertise securities order-taking, provide investment advice or research or make recommendations concerning securities to the account or otherwise solicit securities transactions from the account. In addition, the bank's charges for effecting a securities transaction for the account can not vary based on whether the bank accepted the order for the transaction, or on the quantity or price of the securities to be bought or sold.

The rules also permit a bank to rely on these provisions when it acts as a directed trustee without investment discretion, and extends the exemptions to subcustodians. Administrators, recordkeepers and subcustodians will be able to engage in cross-trades to the same extent that the custodian bank could — meaning they can cross or net orders between the accounts of a particular custodian bank, but not among the accounts of multiple banks. The release identifies the circumstances under which a bank might be considered an impermissible "carrying broker."

Exemption for Banks to Effect Transactions in Investment Company Securities. The rules include an exemption that permits banks to effect certain transactions in mutual funds and in certain variable insurance products that are registered, and funded by a separate account, through the National Securities Clearing Corporation, directly with a transfer agent, or directly with an insurance company or a separate account that is excluded from the definition of transfer agent in Section 3(a)(25) of the Exchange Act. To take advantage of the exemption, the security must not be traded on a national securities exchange or through the facilities of a national securities association or an interdealer quotation system.

Exemption for Banks to Effect Transactions in Company Securities. The rules include an exemption to permit a bank to effect a transaction in the securities of a company directly with a transfer agent acting for the company as long as four conditions are met. First, no commission may be charged with respect to the transaction. Second, the transaction must be conducted solely for the benefit of an employee benefit plan. Third, the security must be obtained directly from the company or an employee benefit plan of the company. And fourth, the security must be transferred only to the company or an employee benefit plan of the company. Securities obtained from, or transferred to, a participant in an employee benefit plan on behalf of the plan are considered to be obtained from, or transferred to, the plan.

Securities Lending Exemption. The exemption for banks from the definition of broker for noncustodial securities lending activities will reinstate a rule that would otherwise be voided by the Regulatory Relief Act. The existing rule was adopted as a part of the bank dealer rules and included exemptions for banks' brokerage activities associated with noncustodial securities lending. The Commission also voted to jointly with the Board request comment regarding repurchase agreements.

Regulation S Securities Exemption. The rules provide an exemption to allow banks to effect certain agency transactions involving Regulation S securities. Banks may rely on the rule if they have a reasonable belief that securities were initially sold in compliance with Regulation S.

Section 29 Exemptions. The rules provide banks with a transitional 18-month exemption to prevent their contracts from being void or voidable under Exchange Act Section 29(b). In addition, the rules provide banks with a permanent exemption from Section 29(b), where a bank has acted in good faith and had reasonable policies and procedures in place to comply with the bank broker rules and regulations, and any violation of the registration requirements did not result in any significant harm, financial loss, or cost to the person seeking to void the contract.

Key Provisions of the SEC-only Release

The second release to be issued by the Commission concerns a conditional exemption from the definition of "dealer" for banks' Regulation S transactions, renumbers the current exemption from the definition of "dealer" for banks' securities lending activities, eliminates outdated rules, and provides a clarifying amendment to Exchange Act Rule 15a-6 to align that rule with the Exchange Act bank broker and dealer provisions and related rules.

These rules will become effective 30 days after their publication in the Federal Register.

Timing and Temporary Exemption

As adopted, Regulation R provides banks with a transitional exemption until the first day of their first fiscal year commencing after Sept. 30, 2008. This will give banks time to make any necessary changes in their systems and compliance programs and should ensure that banks have time to come into compliance with the Exchange Act provisions relating to the broker definition. This exemptive rule will become effective on the date that the Commission's current order expires, Sept. 28, 2007.

The SEC-only rules will become effective 30 days after their publication in the Federal Register.

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The full text of detailed releases concerning these items will be posted to the SEC Web site as soon as possible after action is taken by the Board.

Additional materials:

Video of Chairman's Statement:
- Windows Media Player (12 MB)
- QuickTime (13 MB)

http://www.sec.gov/news/press/2007/2007-190.htm

Home | Previous Page Modified: 09/19/2007