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March 30, 2009

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Ave., NW
Washington, DC 20551

Re: Docket No. R-1343

Dear Ms. Johnson:

This comment letter is submitted on behalf of three national broker-dealers (the "Broker-Dealers") in response to the Proposed Rule issued by the Board of Governors of the Federal Reserve System ("Board") to amend Regulation E ("Proposed Rule") in connection with certain overdraft programs. Each Broker-Dealer is registered as a broker-dealer with the Securities and Exchange Commission ("SEC"). On behalf of the Broker-Dealers, we appreciate the opportunity to comment on the Proposed Rule. The comments in this letter are limited to the application of the Proposed Rule to certain "margin" lines of credit[1] that the Broker-Dealers offer to their clients in connection with their central asset account services ("CAA Services").

I. Description of the CAA Services

Each of the Broker-Dealers provides a CAA Service to its respective clients who sign up for the service that generally operates in the manner described herein. Common features of the CAA Services provided by the Broker-Dealers include: (i) a securities brokerage account ("Brokerage Account"), that may be either a cash account or a margin account, (ii) a "sweep" service that automatically moves free credit balances in the Brokerage Account into a designated short term deposit or investment (typically bank deposits or money market mutual fund shares) ("Sweep Account") when those funds are not needed for transactions in the Brokerage Account, and (iii) cash access and third party payment mechanisms, such as checks and debit cards, that draw on free credit balances in the Brokerage Accounts, balances maintained in the Sweep

[1] We use the term "margin line of credit" in this letter to refer to the credit secured by margin securities in a brokerage account that is extended by the Broker-Dealers under applicable "margin" regulations as described below. Technically, "margin" is a measure of the amount of equity in the brokerage account in excess of debit positions in the account.

Account, and following the exhaustion of such assets, a line of credit extended by the Broker-Dealer if the Brokerage Account is a margin account.

Clients use the Brokerage Accounts to conduct traditional securities transactions, such as purchasing and selling individual securities. Accordingly, the predominant assets in such Brokerage Accounts generally consist of publicly-traded securities. Clients also may have uninvested cash in their Brokerage Accounts arising, for example, from the deposit of cash pending investment by the client, from the proceeds of the sale of the client's securities, and from dividend and interest payments received by the client. In order to provide clients a return on those otherwise uninvested funds, each Broker-Dealer has established a sweep program whereby such funds or "free credit balances" on the books of the Broker-Dealer are invested on behalf of the client in one or more interest-bearing bank deposit accounts maintained by the Broker-Dealer on the client's behalf or in shares of a money market mutual fund. When the client makes a purchase of securities in the Brokerage Account, the Broker-Dealer, on behalf of the client, withdraws (for bank deposits) or redeems (for money market mutual funds) the funds from the Sweep Account in order to pay for the securities transaction.

In light of the cash balances that may be maintained through the Brokerage Account from time to time, the Broker-Dealers also have each provided their clients convenient access to those funds through third party payment mechanisms such as checks and debit cards. When a client draws a check on the Brokerage Account or initiates a debit card transaction from the Brokerage Account, the Broker-Dealer uses the uninvested cash in the Brokerage Account to pay the transaction. Funds are taken first from any free credit balances in the Brokerage Account (for example, due to the settlement of the sale of a security). To the extent the client has insufficient free credit balances in the Brokerage Account to satisfy any debit position, the Broker-Dealer transfers funds on the client's behalf from the client's Sweep Account to the Brokerage Account to pay the client's transaction.

If the client's Sweep Account balance is insufficient to pay any transaction and the client's Brokerage Account is a cash account, the transaction will be rejected for insufficient funds. If the client's Sweep Account balance is insufficient to pay the transaction and the client's Brokerage Account is a margin account, each Broker-Dealer automatically extends margin credit to the client to pay the transaction (if sufficient available margin exists in the Brokerage Account to do so) and the client is charged interest on such advance in accordance with the agreement governing the Brokerage Account ("Account Agreement"). The amount of credit made available to any client in a margin account is determined by the amount of margin securities in the account and the Broker-Dealer's margin and underwriting policies, in each case within the applicable limits established by Regulation T. Interest is charged at a disclosed periodic rate that reflects the fact that the credit is secured by margin stock, i.e., the rates are generally lower than those available for most forms of unsecured consumer credit. The Broker-Dealers automatically apply any cash received into the Brokerage Account (e.g., from a client

deposit, a client's sale of a security, or an interest or dividend payment on a client's security) to reduce the client's outstanding margin credit balance, if any, which limits the amount of interest charges incurred by clients.

For check transactions, the determination whether there are sufficient available funds (cash or credit) to pay a transaction is made by the midnight deadline for return of the check. For debit card transactions, the authorization for the transaction is declined if there are insufficient funds. In this regard, the authorization limit for approval of transactions used by the Broker-Dealers is based on the combination of (i) available free credit balances in the Brokerage Account, (ii) the available balances in the Sweep Account and (iii) available margin credit, if any. Because of the nature of the debit networks through which transactions are processed, there is no way to communicate to the client whether a particular transaction is being authorized against cash assets in the client's Brokerage Account or against available margin credit. The Broker-Dealers' clients have not, however, indicated any concern about this authorization process since they have authorized the use of margin when the Brokerage Account was established or at some later point.

To the contrary, clients choose the CAA Services from each Broker-Dealer specifically because of the convenience provided by those services in managing the clients' free cash, investment assets and associated credit through a single account. To obtain CAA Services from a Broker-Dealer, a client must complete an enrollment process that includes receiving detailed disclosures and entering into an Account Agreement with the Broker-Dealer that sets forth the terms and conditions of the brokerage account and related services. Among other things, the Account Agreement set forth the terms of any margin credit extended to the client.

In this regard, it is important to note that the Broker-Dealers' disclosure of the terms of margin credit is governed by Rule 10b-16, 17 C.F.R. § 240.10b-16 ("Rule 10b-16"), of the SEC. In particular, the Broker-Dealers must provide account-opening disclosures that set forth, among other things, the conditions under which interest is charged, the annual rate of interest, the method of computing interest, the balance computation method used, all fees and charges other than interest, and a description of any liens placed on the client's property. 17 C.F.R. § 240.10b-16(a)(1). The Broker-Dealers also must provide, at a minimum, quarterly statements that, among other things, set forth the margin account's opening and closing balances, a list and description of each margin account transaction during the statement period, interest charges, and all other fees charged to the margin account. 17 C.F.R. § 240.10b-16(a)(2). Rule 10b-16 also generally prohibits the Broker-Dealers from adversely changing the terms and conditions of margin account credit charges unless the client is provided with at least thirty (30) days prior written notice. 17 C.F.R. § 240.10b-16(b).

Following presentation of all of these disclosures and the remaining terms of the Account Agreement, clients are required to sign the Account Agreement. While the Brokerage Account

documentation clearly indicates that margin accounts are the default selection, each Broker-Dealer also provides a prominent "check the box" option for the client to choose a cash account rather than a margin account as part of the Account Agreement or application materials. Accordingly, only clients who desire to establish an account with margin privileges actually receive the benefit of the margin credit discussed above.

II. Margin Account Advances Should be Exempt from the Proposed Rule

The Board has promulgated the Proposed Rule in order to address a perceived gap in the disclosures provided to consumers in connection with "overdrafts" on deposit accounts versus extensions of credit pursuant to overdraft lines of credit subject to Regulation Z. In particular, the Board has responded to consumer concerns that "overdraft" programs do not disclose sufficient information to consumers in a manner that enables to them to manage their cost of credit or adequately compare overdraft expenses to other credit options. The Supplementary Information to the Proposed Rule notes that consumer groups have raised concerns that certain banks use overdraft services to trap unwary low- and moderate-income consumers into paying high flat fees, assess multiple fees on a single day for several small-dollar transactions, charge overdraft fees that exceed the amount of the overdraft and fail to adequately disclose any of the foregoing or provide the consumer an adequate means to avoid such costs.[2] The CAA Services provided by the Broker-Dealers have none of these features.

First, as noted above, the margin credit extended by the Broker-Dealers through the CAA Services is a low-cost form of credit for which interest, rather than per transaction fees, is charged and for which automated repayment features are supported. Margin credit is not a service that is targeted at generating fee income from low- or moderate-income consumers, but rather is a feature of a brokerage accounts for consumers who otherwise have the financial capacity to take significant equity positions in securities. In addition, the Broker-Dealers are obligated under applicable suitability requirements to consider whether margin credit is suitable for a client in light of, among other things, the client's financial situation before recommending margin credit to the client.

Second, similar to lines of credit that are covered by Regulation Z, margin credit in the Brokerage Accounts is subject to disclosure requirements imposed by the SEC as outlined above. Thus, clients who utilize margin credit in order to meet transactional needs have adequate information both at the establishment of the relationship and on an on-going basis to evaluate their cost of credit and make intelligent decisions regarding their cash management.

Finally, in addition to the clear and conspicuous disclosure of the terms and conditions of margin credit, and of the other elements of the Brokerage Accounts, each of the Broker-Dealers

[2] 74 Fed. Reg. 5212, 5213 (Jan. 29, 2009).

prominently provides their clients a simple "check-the-box" option to choose a cash account rather than a margin account in the Account Agreement or application. Thus, the availability of margin as a source of funds to cover drafts on a Brokerage Account truly is a convenience to clients who are fully informed of the options available to them and have ample opportunity to choose to forego the advantages of a margin account.

Since the CAA Services involve none of the public policy concerns that the Proposed Rule is designed to address, it would be inappropriate to subject the Brokerage Accounts to the Proposed Rule. Indeed, the Proposed Rule already contains an exemption for the payment of a consumer's overdraft from a line of credit subject to Regulation Z because that regulation already provides more than adequate consumer protections. *See* Proposed 12 C.F.R. § 205.17(a)(1). By utilizing the Regulation Z cross-reference, however, the Board has inadvertently failed to include margin credit in the exemption. This is because margin credit is exempt from Regulation Z pursuant to 12 C.F.R. 226.3(d) ("This regulation does not apply to . . . [t]ransactions in securities or commodities accounts in which credit is extended by a broker-dealer registered with the Securities and Exchange Commission or the Commodity Futures Trading Commission."). The reason that margin credit is exempt from Regulation Z, however, is precisely because it is already adequately regulated and supervised by the SEC as noted above. It would be an illogical result for the Board to regulate margin credit through the Proposed Rule by virtue of the fact that margin credit is already exempted from the Board's principal consumer credit regulation. The Board should not ignore the parallel system of regulation provided by the SEC in crafting the exemptions contained in the Proposed Rule.

Accordingly, on behalf of the Broker-Dealers, we respectfully suggest that the Board amend the exemption from the Proposed Rule for lines of credit subject to Regulation Z so that it also includes credit that is subject to Regulation Z's securities and commodities accounts exemption at 12 C.F.R. § 205.17(a)(1).

* * *

We appreciate the opportunity to comment on the Proposed Rule and would be pleased to discuss any of the issues raised herein in greater detail. If you have any questions, please contact David Teitelbaum at (202) 736-8683 or by email at dteitelbaum@sidley.com, or Blayne Scofield at (202) 468-7954 or by email at bscofield@sidley.com.

Sincerely,

David E. Teitelbaum