

Legal Department

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BY FIRST CLASS MAIL AND
ELECTRONIC MAIL

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Secretary
Securities and Exchange Commission
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Rule-comments@sec.gov
File No. S7-22-06

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551
Regs.comments@federalreserve.gov
Docket No. R1274

Re: Comments on Proposed Rule: Definitions of Terms and Exemptions Relating to the "Broker" Exceptions for Banks ("Regulation R")

Dear Ms. Morris and Ms. Johnson:

Bank of America Corporation ("Bank of America") and its subsidiaries appreciate the opportunity to comment on the proposed Regulation R jointly issued by the Securities and Exchange Commission ("Commission") and Board of Governors of the Federal Reserve System ("Board") (collectively, the "Agencies").¹ As an initial matter, Bank of America would like to express its appreciation to the respective staffs of the Commission and the Board for their extraordinary effort in developing proposed Regulation R. In addition, we would like to voice our agreement with and full support for the points raised in The Clearing House Association L.L.C.'s ("The Clearing House") and American Bankers Association's ("ABA") and its affiliate's, the ABA Securities Association ("ABASA"), respective comment letters on proposed Regulation R.

Bank of America is a financial holding company with almost \$1.5 trillion in total assets. We operate the largest and most diverse banking network in the United States. We maintain full-service consumer and commercial banking operations in 30 states and the District of

¹ See *Definitions of Terms and Exemptions Relating to the "Broker" Exceptions for Banks*, Exchange Act Release No. 54946 (Dec. 18, 2006), 71 Fed. Reg. 77522 (Dec. 26, 2006) ("Proposing Release").

Columbia. Through our various subsidiaries we provide a broad range of financial products and services to over 33 million households and two million businesses. Additionally, we provide securities brokerage and underwriting services to individuals, corporations, and investors through our registered broker-dealer affiliates, Banc of America Securities, LLC and Banc of America Investment Services, Inc.

I. BACKGROUND

Section 201 of Title II of the Gramm-Leach-Bliley Act ("GLBA") eliminated the blanket exception for banks from the definition of "broker" under Section 3(a)(4) of the Securities Exchange Act of 1934 ("Exchange Act") and replaced that exception with more specific activity-focused exceptions applicable to certain traditional bank securities activities. Congress designed the new exceptions to permit banks to continue providing trust, fiduciary, custodial, employee benefit plan servicing, and other traditional banking services to meet customers' financial needs and to foster competition among financial institutions and choice for consumers within the financial services industry.

Proposed Regulation R would implement certain of the GLBA bank broker exceptions by defining various terms used in these statutory exceptions and implementing certain targeted exemptions for banks relating to third-party networking arrangements, trust and fiduciary activities, sweep activities, and safekeeping and custody activities.²

Bank of America believes that proposed Regulation R is a significant improvement over prior proposals to regulate bank securities broker activities. We believe proposed Regulation R reflects a deeper commitment to realizing the promise of functional regulation. We also believe that proposed Regulation R generally represents a better understanding of the nature and conduct of traditional banking activities and is a more effective approach to assuring investor protection.

While Bank of America believes that much of proposed Regulation R and the views expressed in the Proposing Release are more sensible and practical than prior initiatives in this area, we would like to call the Agencies' attention to several elements of the proposal that we believe require modification or clarification. In particular, we request that the Agencies consider various modifications or clarifications relating to the networking exception and exemption and the trust and fiduciary activities exception. We also would like to highlight the need to clarify the treatment of dual employees under applicable self-regulatory organization ("SRO") rules.

² See 15 U.S.C. § 78c(a)(4)(B)(i), (ii), (v) and (viii) (2007).

II. NETWORKING ARRANGEMENTS

Section 3(a)(4)(B)(i) of the Exchange Act provides an exception from the definition of broker that permits banks to contract with broker-dealers under certain conditions in order to offer bank customers financial services that include securities brokerage services without the bank having to register as a broker (“Networking Exception”).³ The specific requirements of the Networking Exception trace their origin to various federal securities and banking law rules and guidelines issued in the 1990s (“Networking Guidance”).⁴

The Networking Exception includes numerous conditions that a bank must meet in order to qualify for the exception. In particular, the Networking Exception provides that non-licensed bank employees may not be paid incentive compensation for referring bank customers to a broker-dealer.⁵ Under the Networking Exception, non-licensed bank employees may, however, receive a “nominal one-time cash fee of a fixed dollar amount” for referring bank customers to the broker-dealer if the referral fee is not “contingent on whether the referral results in a transaction.”⁶

Proposed Regulation R defines certain terms used in the Networking Exception related to referral fees and also provides an exemption with respect to the payment of fees for referrals of certain institutional and high net worth customers.

A. *Definition of “Nominal One-Time Cash Fee” – Bank Employees Paid Contingent Compensation*

Under proposed Regulation R, the phrase “nominal one-time cash fee of a fixed dollar amount” would be defined as a cash payment for a referral in an amount that meets any one of three alternative standards.⁷ The three general alternative forms of payment relate to the

³ See 15 U.S.C. § 78c(a)(4)(B)(i) (2007).

⁴ See Interagency Statement on the Retail Sales of Non-Deposit Investment Products (Feb. 15, 1994) (“Interagency Statement”); SEC No-Action Letter *In Re: Chubb Securities Corporation* (Nov. 24, 1993); and NASD Conduct Rule 2350. The Networking Guidance generally is intended to: (1) create a clear and well-documented delineation of shared and allocated responsibilities of the bank and the broker under the networking arrangement; (2) avoid customer confusion regarding which entity is providing a particular product or service and what protections the customer is afforded under applicable banking and securities law; (3) further investor protection by limiting the compensation and activities of non-licensed bank employees; and (4) assure that customers understand the risks associated with non-deposit investment products.

⁵ In general, the limitations on bank employee referral compensation are intended to assure that non-licensed bank employees are not provided a “salesman’s stake” in referring bank customers to a broker-dealer. In addition, the other requirements of the Networking Exception, in many respects, are intended primarily to protect unsophisticated consumer banking customers.

⁶ See 15 U.S.C. § 78c(a)(4)(B)(i)(VI) (2007).

⁷ Proposed Exchange Act Rule 700(c).

hourly or annual salary for the job family that includes an employee, the actual hourly wage of the employee, or a flat \$25 fee.⁸

Bank of America would like to note that there are a considerable number of non-licensed bank employees whose compensation is not based on an hourly or annual fixed wage. For example, there are certain bank employees whose compensation is largely contingent upon the sale of banking products such as mortgage loans and other credit arrangements. These employees are subject to extensive regulation under applicable banking law.

In order to accommodate non-licensed bank employees whose compensation is contingent upon the sale of traditional bank products we recommend that the Agencies consider implementing ABASA's proposed approach regarding referral fee payments to this category of employees. This alternative approach would not circumvent the "nominal" or "incentive" requirements of the Networking Exception and would foster investor protection because such employees' compensation, similar to hourly and annual fixed wage employees, would not be tied to the size, volume or occurrence of a securities transaction.

B. *Definition of "Incentive Compensation"*

The Networking Exception prohibits non-licensed bank employees that refer customers to a broker-dealer from receiving "incentive compensation" for the referral. Proposed Regulation R defines "incentive compensation" as compensation that is intended to encourage a bank employee to refer potential customers to a broker-dealer or give a bank employee an interest in the success of a securities transaction at a broker-dealer.⁹

Proposed Regulation R excludes from the definition of incentive compensation certain types of bonus compensation programs. The proposal, in particular, excludes compensation paid by a bank under a bonus or similar plan that is paid on a discretionary basis and based on multiple factors or variables. These factors or variables must include significant factors or variables that are not related to securities transactions at a broker-dealer and may not include referrals to a broker-dealer.¹⁰ Proposed Regulation R would permit a bank to compensate its employees based on overall profitability of the bank and, under certain conditions, a broker-dealer.

Bank of America would like to voice our agreement with and full support for the points raised in ABASA's Regulation R comment letter regarding the Agencies proposed definition of incentive compensation and treatment of traditional bank bonus programs. In addition, we would like to express our agreement with the suggestion included in The Clearing House's comment letter that the Agencies should permit banks to pay bonuses based on "financial

⁸ Proposed Exchange Act Rule 700(c).

⁹ Proposed Exchange Act Rule 700(b).

¹⁰ Proposed Exchange Act Rule 700(b)(1)(ii)(A).

performance” rather than solely on “overall profitability.” Banks oftentimes use factors other than overall profitability to make compensation decisions. We believe using a “financial performance” standard should not implicate investor protection concerns while also providing banks with needed flexibility to structure their compensation programs.

C. *High Net Worth and Institutional Customer Referral Exemption*

In a significant departure from prior rulemakings addressing bank securities broker activities, proposed Regulation R includes a conditional exemption that would permit a bank to pay a non-licensed bank employee a contingent referral fee of more than a nominal amount for referring an “institutional customer” or “high net worth customer” to a broker-dealer (“Institutional Referral Exemption”). In addition to the conditions included in the statutory Networking Exception, the Institutional Referral Exemption includes several detailed conditions, including customer disclosure and notice requirements.¹¹

The proposal also provides definitions of “institutional customer” and “high net worth customer.” Generally, “institutional customer” is defined to include any non-natural person that has at least \$10 million in investments or \$40 million in assets. A non-natural person also may qualify as an “institutional customer” with respect to a referral if the customer has at least \$25 million in assets and the bank employee refers the customer to the broker-dealer for investment banking services.¹² A “high net worth customer” is defined to mean any natural person who, either individually or jointly 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.¹³

1. Definitions of Institutional and High Net Worth Customers

At the outset, Bank of America would like to express its appreciation to the Agencies for proposing the Institutional Referral Exemption. We believe the exemption recognizes that the Networking Exception was primarily drafted with less sophisticated retail customers in mind and that customers with a certain degree of wealth should be presumed to be sufficiently sophisticated to understand the risks associated with investing in products not insured by the Federal Deposit Insurance Corporation (“FDIC”) and the implications of a bank employee having a financial stake in the success of a referral.

a. *High Net Worth Customers*

We believe, however, that proposed Regulation R sets the bar too high with respect to the types of persons who qualify as institutional or high net worth customers. In particular,

¹¹ Proposed Exchange Act Rule 701.

¹² Proposed Exchange Act Rule 701(d)(2).

¹³ Proposed Exchange Act Rule 701(d)(1).

proposed Regulation R's definition of high net worth customer uses a net worth threshold of \$5 million. We believe this threshold amount is too high. Individuals with a lower net worth or meeting other financial criteria are permitted to, among other things, invest in private placements under Regulation D (*i.e.*, net worth of \$1 million or income in excess of \$200,000 in each of the two most recent years) and be charged a performance-based fee by a Commission registered investment adviser (*e.g.*, net worth of \$1.5 million).¹⁴ In addition, the Commission recently proposed that the "accredited investor" standard in Regulation D be raised to \$2.5 million in investments for eligibility to invest in certain hedge funds.¹⁵

Bank of America would like to note that the federal securities laws are replete with various definitions of high net worth or sophisticated investors.¹⁶ The Agencies' proposed definitions of institutional customer and high net worth customer would merely add to this laundry list of divergent definitions.

We believe that the Agencies should consider defining high net customers to include persons that meet the recently proposed definition of "accredited natural person."¹⁷ Accredited natural persons would be a new category of investors under Regulation D who would be permitted to invest in certain hedge funds. We believe if this category of persons is understood by the Commission to have the sophistication to understand and appreciate investments in hedge funds they also should have a sufficient level of sophistication to understand the difference between bank and securities products and between FDIC insurance and Securities Investor Protection Corporation ("SIPC") protection.

b. Institutional Customers

Bank of America also believes that the asset and investment thresholds within the definition of institutional customer are set too high. We believe these thresholds should be lowered in order to offer small companies more choice for sources of financial products and services and capital. Maintaining the thresholds at the proposed levels might result in smaller companies and non-profits having to choose from a smaller universe of financial services providers. This approach also appears to be at odds with the Commission's apparent desire to foster access to capital and financial services by smaller companies. For example, the Commission's recent hedge fund proposal includes an exception for venture capital funds so

¹⁴ 17 C.F.R. § 275.205-3 (2007).

¹⁵ See *Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles; Accredited Investors in Certain Private Investment Vehicles*, Securities Act Release No. 8766 (Dec. 27, 2006), 72 Fed. Reg. 400 (Jan. 4, 2007) ("Hedge Fund Proposal").

¹⁶ See, *e.g.*, 17 C.F.R. § 230.144A (2007) (defining "qualified institutional buyer" under Rule 144A); 17 C.F.R. § 230.501 (2007) (defining "accredited investor" under Regulation D); proposed 17 C.F.R. § 230.509 (2007) (proposing new category of persons permitted to invest in certain private investment funds); 15 U.S.C. § 78c(a)(54) (2007) (defining "qualified investor" under the Exchange Act); and 15 U.S.C. § 80a-2(a)(51) (2007) (defining "qualified purchaser" under Section 2(a)(51) of the Investment Company Act of 1940).

¹⁷ See generally *Hedge Fund Proposal*.

that small businesses can have increased access to investors.¹⁸ Moreover, the Commission staff has recently granted no-action relief from broker-dealer registration to a company that offers capital raising services to small businesses.¹⁹ We believe lowering the investment and asset thresholds under the Institutional Referral Exemption will foster the goal of providing increased choice to smaller companies without impacting investor protection concerns.

c. Entities Owned or Managed by Qualified Persons

We suggest that the definitions of institutional and high net worth customers should be amended to include entities that are owned or managed by persons that individually qualify as institutional or high net worth customers. For example, we believe the proposed definition of high net worth customer should include a revocable trust where the settlor of the trust qualifies as a high net worth customer. There should be no distinction from an investor protection standpoint between a person who invests directly and a person who invests through a trust vehicle. As long as the underlying investor individually meets the definition of a high net worth customer any vehicle used by that investor should also qualify for the Institutional Referral Exemption. The same analysis should apply for family limited partnerships where the general partner qualifies as a high net worth customer. We note that the federal securities laws currently recognize this concept. For example, an entity owned by accredited investors generally is considered to be an accredited investor under Regulation D.²⁰

2. Procedural Aspects of Institutional Referral Exemption

a. Performance of the Exemption's Requirements

The Institutional Referral Exemption includes numerous procedural hurdles that the bank and networking broker-dealer must meet in order to qualify for the exemption. Many of these requirements appear to be redundant and overly complex. For example, the exemption requires both the broker-dealer and the bank to make a determination that the referring bank *employee is not subject to a statutory disqualification and that the customer is an institutional customer or high net worth customer.*²¹

Bank of America believes that the Institutional Referral Exemption should be streamlined and made less complex from a procedural standpoint. We believe the Agencies should amend the Institutional Referral Exemption to require that a function, such as making a

¹⁸ See Hedge Fund Proposal at 405.

¹⁹ See SEC No-Action Letter, *In Re: Country Business Inc.* (Nov. 8, 2006).

²⁰ See 17 C.F.R § 230.501(a)(8) (2007).

²¹ Proposed Exchange Act Rules 701(a)(1)(i)(C) and 701(a)(2)(iii).

statutory disqualification determination, be operationally performed only once by either the bank or the broker-dealer. We also believe that the exemption should be amended to provide that no matter who performs a function both the bank and the broker-dealer will be held responsible or accountable for the performance of the function. The Agencies also should consider permitting the bank and the broker-dealer to determine between themselves who is better positioned to undertake a particular responsibility under the arrangement. This approach would be similar to the current approach the Commission and self-regulatory organizations take with respect to introducing broker and clearing broker arrangements.²² This approach would leverage the respective expertise of the broker-dealer and bank, recognize that a one-size-fits-all model is not efficient or cost effective, and help lower overall costs to customers' benefit. If issues arise regarding particular networking arrangements, the federal banking agencies can address these issues through the examination process and, if required, Commission and Board staff can issue interpretive guidance.

b. Disclosure & Status Determinations under the Exemption

Several of the conditions of the Institutional Referral Exemption require the bank to make certain disclosures and a range of determinations prior to or at the time of making a referral. Making the required determinations and providing the required written disclosures at the time of or before a referral is made may be impossible or impractical in certain situations, such as referrals that occur through oral conversations over the phone or electronically over the internet (such as through e-mail).

Bank of America requests that the Agencies consider permitting after-the-fact written disclosures if such disclosures occur shortly after a referral is made or that short form disclosures be used in certain situations (similar to the short form "NDIP disclosures" permitted under the Interagency Statement and NASD Conduct Rule 2350). We believe taking this approach is in line with prior guidance regarding disclosure requirements in networking arrangements and will foster investor protection and avoid customer confusion while recognizing business practicalities.

3. "Ordinary Course of Business" Requirement

The Institutional Referral Exemption requires that a non-licensed bank employee must encounter the high net worth customer or institutional customer in the "ordinary course" of the bank employee's assigned duties for the bank.²³ Bank of America would like to note for the Agencies that many bank employees do not have 9 to 5 jobs that stop at the front door of their office buildings. Many bank employees come across possible new customers or new business opportunities outside the ordinary confines of the work week, such as while on vacation or attending a neighborhood picnic.

²² See, e.g., NASD Conduct Rule 3230.

²³ Proposed Exchange Act Rule 701(a)(1)(ii).

Bank of America understands the “ordinary course” of business requirement in the Institutional Referral Exemption to mean that a non-licensed bank employee may not be primarily involved in seeking out securities referrals, but, rather, must have a legitimate core banking job and must encounter securities referral opportunities in connection with that core banking job.

III. TRUST & FIDUCIARY ACTIVITIES EXCEPTION

Section 3(a)(4)(B)(ii) of the Exchange Act contains an exception from the definition of broker that permits a bank, under certain conditions, to effect securities transactions in a trustee or fiduciary capacity without registering as a broker (“Trust Exception”). In order to qualify for the Trust Exception, a bank must, among other things, effect such transactions in either its trust department or in another department examined regularly for compliance with fiduciary principles and standards and be “chiefly compensated” based on a statutory list of permissible fees.²⁴

Under proposed Regulation R, a bank’s compliance with the chiefly compensated requirement hinges on whether the bank receives more in fees paid for traditional work done by trustees and fiduciaries (“relationship compensation”) than fees traditionally received by broker-dealers. Proposed Regulation R requires that a bank’s “relationship-total compensation percentage” received from each trust and fiduciary account be greater than 50%.²⁵ The proposal requires banks to calculate their relationship-total compensation percentage on an account-by-account basis and provides guidance regarding the types of fees that qualify as permissible relationship compensation. Proposed Regulation R also provides an exemption that permits a bank to meet the “chiefly compensated” requirement on a bank-wide basis.²⁶

A. *Definition of Relationship Compensation*

As an initial matter, Bank of America would like to express its appreciation for the Agencies’ efforts in crafting the bank-wide exemption from the account-by-account calculation. We believe the bank-wide alternative is a workable approach that appropriately balances the needs of investor protection and practical business considerations. We commend the Agencies for their efforts in this area.

Under proposed Regulation R, “relationship compensation” is defined to include, among other things, various fees paid by an investment company to a bank trustee or fiduciary.²⁷

²⁴ See 15 U.S.C. § 78c(a)(4)(B)(ii) (2007).

²⁵ Proposed Exchange Act Rule 721(a)(1).

²⁶ Proposed Exchange Act Rule 722(a).

²⁷ Proposed Exchange Act Rule 721(a)(4).

We request clarification that permissible fee payments may also come from an investment adviser, distributor or other person affiliated with an investment company. Bank of America believes that Congress intended the Trust Exception to cover fee payments that would be permissible for a fiduciary to accept. So long as fiduciary principals permit a bank to accept a particular fee that fee should be permissible under the Trust Exception.

B. *Bank-Wide Exemption*

Proposed Regulation R includes an exemption that permits a bank to meet the chiefly compensated requirement on a bank-wide basis if the “aggregate-relationship-total compensation percentage” for the bank’s trust and fiduciary business is at least 70 percent.²⁸ Bank of America requests clarification that the bank-wide calculation may be made on either an individual bank basis or on a consolidated bank holding company basis.

IV. Dual Employees: NASD Conduct Rules 3030 and 3040

As you are aware, NASD Conduct Rules 3030 and 3040 generally require broker-dealers and their associated persons to satisfy certain requirements regarding the activities of such associated persons outside their employment with the broker-dealer.²⁹ For example, if an associated person is involved in a private securities transaction outside that person’s employment with a broker-dealer NASD Conduct Rule 3040 requires, among other things, that such person’s activities be supervised by the broker-dealer. This requirement might affect dual employees of a bank and a broker-dealer where such employees engage in bank permissible securities activities outside such persons’ employment with the broker-dealer. NASD Conduct Rule 3040 could arguably require the broker-dealer to supervise the employee’s permissible bank securities activities, but such a result would be counter to Congressional intent to implement functional regulation through the provisions of the GLBA.

While Bank of America believes that proposed Regulation R represents a dramatic step forward in effecting the “push-out” provisions of Title II of the GLBA along lines which reflect traditional and fundamentally sound business practices, the proposed regulation and Proposing Release do not address the lingering question of the appropriate oversight by the Commission and SROs over the non-brokerage related activities of dual employees of banks and brokers. Bank of America continues to believe that the requirements of NASD Conduct Rules 3030 and 3040 were developed for circumstances in which an associated person’s outside activities are subject to far less supervision and regulation than they are in the case of a bank employee. Bank employees performing any function for a bank are subject to extensive regulation of their activities. Banks and their employees are some of the most highly regulated persons in the world. Requiring an additional layer of regulation would be redundant and potentially add to the costs of doing business without any appreciable customer protection benefits. We urge the Agencies and the applicable SROs to address the

²⁸ Proposed Exchange Act Rule 722(a)(2).

²⁹ See generally NASD Conduct Rules 3030 and 3040.

various issues associated with dual employees prior to the compliance date of proposed Regulation R.

V. Future Interpretations of Regulation R

We believe proposed Regulation R shows that the Agencies can work together effectively to implement reasonable rules that encapsulate sound functional regulation principles that work for investors and business alike. We strongly encourage the Agencies to continue to follow the mandate included in Section 101(b) of the Financial Services Regulatory Relief Act and jointly issue any future amendments or additions to proposed Regulation R. We also strongly encourage the Agencies to continue to work together to issue uniform interpretations of Regulation R and to consult with one another regarding enforcement actions and administrative proceedings.

* * *

Bank of America appreciates the opportunity to comment on proposed Regulation R. We believe the proposed rule represents a balanced and fair approach to the issues raised by bank securities broker activities and is a well reasoned implementation of Title II of GLBA. Please contact the undersigned should you have any questions or require additional information regarding our comments.

Sincerely,



Gregory A. Baer
Deputy General Counsel

Cc: Tim Greenway
Office of the Comptroller of the Currency
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