

## REGULATION R – Rules 701, 723, and 741

### SUPPORTING STATEMENT

#### 1. Necessity for Information Collection

##### a. Background

The GLBA amended several federal statutes governing the activities and supervision of banks, bank holding companies, and their affiliates.<sup>1</sup> Among other things, it lowered barriers between the banking and securities industries erected by the Banking Act of 1933 (“Glass-Steagall Act”).<sup>2</sup> It also altered the way in which the supervisory responsibilities over the banking, securities, and insurance industries are allocated among financial regulators. Among other things, the GLBA repealed most of the separation of investment and commercial banking imposed by the Glass-Steagall Act. The GLBA also revised the provisions of the Exchange Act that had completely excluded banks from broker-dealer registration requirements.

In enacting the GLBA, Congress adopted functional regulation for bank securities activities, with certain exceptions from Commission oversight for specified securities activities. With respect to the definition of “broker,” the Exchange Act, as amended by the GLBA, provides eleven specific exceptions for banks.<sup>3</sup> Each of these exceptions permits a bank to act as an agent with respect to specified securities products or in transactions that meet specific statutory conditions.

In particular, section 3(a)(4)(B) of the Exchange Act provides conditional exceptions from the definition of broker for banks that engage in certain securities activities in connection with third-party brokerage arrangements;<sup>4</sup> trust and fiduciary activities;<sup>5</sup> permissible securities transactions;<sup>6</sup> certain stock purchase plans;<sup>7</sup> sweep accounts;<sup>8</sup> affiliate transactions;<sup>9</sup> private

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<sup>1</sup> Pub. L. No. 106-102, 113 Stat. 1338 (1999).

<sup>2</sup> Pub. L. No. 73-66, ch. 89, 48 Stat. 162 (1933) (as codified in various sections of 12 U.S.C.).

<sup>3</sup> 15 U.S.C. 78c(a)(4).

<sup>4</sup> Exchange Act section 3(a)(4)(B)(i). This exception permits banks to enter into third-party brokerage, or “networking” arrangements with brokers under specific conditions.

<sup>5</sup> Exchange Act section 3(a)(4)(B)(ii). This exception permits banks to effect transactions as trustees or fiduciaries for securities customers under specific conditions.

<sup>6</sup> Exchange Act section 3(a)(4)(B)(iii). This exception permits banks to buy and sell commercial paper, bankers’ acceptances, commercial bills, exempted securities, certain Canadian government obligations, and Brady bonds.

<sup>7</sup> Exchange Act section 3(a)(4)(B)(iv). This exception permits banks, as part of their transfer agency activities, to effect transactions for certain issuer plans.

securities offerings;<sup>10</sup> safekeeping and custody activities;<sup>11</sup> identified banking products;<sup>12</sup> municipal securities;<sup>13</sup> and a de minimis number of other securities transactions.<sup>14</sup>

On October 13, 2006, President Bush signed into law the “Financial Services Regulatory Relief Act of 2006 (“Regulatory Relief Act”).”<sup>15</sup> Among other things, the Regulatory Relief Act requires that the Securities and Exchange Commission (the “Commission” or “SEC”) and the Board of Governors of the Federal Reserve System (the “Board,” and collectively with the Commission, the “Agencies”) jointly adopt a single set of rules to implement the bank broker exceptions in section 3(a)(4) of the Exchange Act.<sup>16</sup> It also requires that not later than 180 days after the date of enactment of the Regulatory Relief Act, the SEC and the Board jointly issue a single set of proposed rules to implement these exceptions.

The Agencies are now proposing rules designed to define and clarify a number of the statutory exceptions from the definition of “broker” under Exchange Act section 3(a)(4). In addition, proposed rules would grant new conditional exemptions from the “broker” definition to banks.

b. Proposed Collections of Information

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<sup>8</sup> Exchange Act section 3(a)(4)(B)(v). This exception permits banks to sweep funds into no-load money market funds.

<sup>9</sup> Exchange Act section 3(a)(4)(B)(vi). This exception permits banks to effect transactions for affiliates, other than broker-dealers.

<sup>10</sup> Exchange Act section 3(a)(4)(B)(vii). This exception permits certain banks to effect transactions in certain privately placed securities, under certain conditions.

<sup>11</sup> Exchange Act section 3(a)(4)(B)(viii). This exception permits banks to engage in certain enumerated safekeeping or custody activities, including stock lending as custodian.

<sup>12</sup> Exchange Act section 3(a)(4)(B)(ix). This exception permits banks to buy and sell certain “identified banking products,” as defined in section 206 of the GLBA.

<sup>13</sup> Exchange Act section 3(a)(4)(B)(x). This exception permits banks to effect transactions in municipal securities.

<sup>14</sup> Exchange Act section 3(a)(4)(B)(xi). This exception permits banks to effect up to 500 transactions in securities in any calendar year in addition to transactions referred to in the other exceptions.

<sup>15</sup> Pub. L. No. 109-351, 120 Stat. 1966 (2006).

<sup>16</sup> See Exchange Act section 3(a)(4)(F), as added by section 101 of the Regulatory Relief Act. The Regulatory Relief Act also requires that the Board and SEC consult with, and seek the concurrence of, the OCC, FDIC and OTS prior to jointly adopting final rules. The Board and the SEC also have consulted extensively with the OCC, FDIC and OTS in developing these joint proposed rules.

The proposed rules would contain three collections of information. The first collection of information is found in proposed Exchange Act Rule 701, which provides a conditional exemption from the definition of “broker” under Exchange Act section 3(a)(4). This proposed rule would require banks that wish to utilize the exemption to make certain disclosures to high net worth or institutional customers when a bank employee receives a referral fee for making a referral to a broker or dealer. This proposed rule would also require a broker or dealer (as part of a written agreement between the bank and the broker or dealer) to notify the bank if the broker or dealer makes certain determinations regarding the financial status of the customer, a bank employee’s statutory disqualification status, and compliance with suitability or sophistication standards. In addition, the bank would be required to provide its broker or dealer partner with the name of the bank employee receiving the referral fee and certain other identifying information.<sup>17</sup>

The second collection of information is contained in proposed Exchange Act Rule 723. This proposed rule would require a bank that desires to exclude a trust or fiduciary account in determining its compliance with the chiefly compensated test (pursuant to a de minimus exclusion)<sup>18</sup> to maintain records demonstrating that the securities transactions conducted by or on behalf of the account were undertaken by the bank in the exercise of its trust or fiduciary responsibilities with respect to the account.

The third collection of information is found in proposed Exchange Act Rule 741 which provides a conditional exemption from the definition of the term “broker” under section 3(a)(4) of the Exchange Act for effecting transactions on behalf of a customer in securities issued by a money market fund. This proposed rule would require a bank relying on the exemption to provide customers with a prospectus for money market fund securities purchased that are not no-load, not later than at the time the customer authorizes the bank to effect the transaction.

Banks would be required to retain the records in compliance with any existing or future recordkeeping requirements established by the Banking Agencies.

The Agencies are issuing the proposed rules pursuant to statutory authority granted in section 101 of the Regulatory Relief Act. In addition, the Commission is issuing the proposed rules pursuant to statutory authority granted in the Exchange Act and, in particular, sections 3(b), 15, 23(a), and 36 thereof.<sup>19</sup>

c. Necessity of the Collections of Information

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<sup>17</sup> See proposed Exchange Act Rule 701(a)(2)(iii).

<sup>18</sup> See proposed Exchange Act Rule 723(d)(2), which would require that the total number of accounts excluded by the bank, under the exclusion from the chiefly compensated test in proposed Rule 721(a)(1), do not exceed the lesser of 1 percent of the total number of trust or fiduciary accounts held by the bank (if the number so obtained is less than 1, the amount would be rounded up to 1) or 500.

<sup>19</sup> 15 U.S.C. 78c(b), 78o, 78w(a), and 78mm.

The collections of information contained in Rules 701, 723, and 741 are integral to the implementation of the Agencies' proposed rules. These proposed rules generally make the guidance and exemptions provided in those rules more useful to the industry while preserving the investor protection principles of the GLBA.

## 2. Purposes of, and Consequences of Not Requiring, the Information Collections

The purpose of the collection of information in proposed Exchange Act Rule 701(a)(2)(i) and (b) is to provide a customer of a bank relying on the exemption with information to assist the customer in identifying and assessing any conflict of interest on the part of the bank employee making a referral to a broker or dealer. The collection of information in proposed Exchange Act Rule 701(a)(2)(iii) and (a)(3)(iii) is designed to help a bank determine whether it is acting in compliance with the proposed exemption. Without this collection of information, bank customers may have insufficient information to determine if a referral made by bank employee is in the customer's best interest. In addition, a bank may have difficulty determining whether it is acting in compliance with the proposed exemption.

The collection of information in proposed Exchange Act Rule 723 is designed to help ensure that a bank relying on the de minimis exclusion would be able to demonstrate that it was acting in a trust or fiduciary capacity with respect to an account excluded from the chiefly compensated test in proposed Rule 721(a)(1). Without this collection of information, banks relying on the de minimis exclusion from the chiefly compensated test would not be required to have documentary evidence of their compliance with the requirements of the rule, which could frustrate regulators' efforts to assess compliance with the rule.

The purpose of the collection of information in proposed Exchange Act Rule 741 is to help ensure that a customer of a bank relying on the exemption would have sufficient information upon which to make an informed investment decision, in particular, regarding the fees the customer would pay with respect to the securities. Without this collection of information, bank customers would not be provided with important information they need to make an informed investment decision.

The Agencies intend for the proposed rules to provide legal certainty to the industry with respect to the GLBA requirements. The Agencies also seek to make the restrictions imposed by the GLBA more accommodating of securities activities carried out by banks consistent with investor protection principles.

## 3. Role of Improved Information Technology and Obstacles to Reducing Burden

Improved information technology would not reduce the burden because each respondent would still be required to provide the same disclosures.

4. Efforts to Identify Duplication

Not applicable; there is no duplication of information.

5. Effects on Small Entities

The requirements of the proposed rules would not be unduly burdensome on smaller banks or broker-dealers. No other small entities are affected by the proposed rules.

6. Consequences of Less Frequent Collection

Less frequent collection of information under proposed Rules 701, 723 and 741 would undermine the purpose of the proposed rules.

7. Inconsistencies with Guidelines in 5 CFR 1320.5(d)(2)

Not applicable; the information is collected in a manner consistent with 5 CFR 1320.5(d)(2).

8. Consultations Outside the Agency

All Commission and Board rule proposals are published in the Federal Register for public comment before adoption. The comment period for the release that discussed the proposed rules is 90 days. This comment period will afford the public an opportunity to respond to the proposal.

9. Payment or Gifts to Respondents

Not applicable.

10. Assurances of Confidentiality

Not applicable.

11. Sensitive Questions

Not applicable; no questions of a sensitive nature are asked.

12. Estimate of Respondent Reporting Burden

The Agencies estimate that approximately 1,000 banks annually would use the exemption in proposed Exchange Act Rule 701 and each bank would on average make the required referral fee disclosures to 200 customers annually and provide one notice annually to its broker or dealer partner regarding the name of a bank employee and other identifying information. The Agencies

also estimate that broker-dealers would, on average, notify each of the 1,000 banks approximately two times annually about a determination regarding a customer's high net worth or institutional status or suitability or sophistication standing as well as a bank employee's statutory disqualification status.

Based on these estimates, the Agencies anticipate that proposed Exchange Act Rule 701 would result in approximately 200,000 disclosures to customers, 1,000 notices to brokers or dealers, and 2,000 notices to banks per year. The Agencies further estimate (based on the level of difficulty and complexity of the applicable activities) that a bank would spend approximately 5 minutes per customer to comply with the disclosure requirement and 15 minutes per notice to a broker or dealer. The Agencies also estimate that a broker or dealer would spend approximately 15 minutes per notice to a bank. Thus, the estimated total annual reporting and recordkeeping burden for these requirements in proposed Exchange Act Rule 701 are 16,917 hours for banks and 500 hours for brokers or dealers.

Because the Agencies expect a small number of banks would use the account-by-account approach in monitoring their compensation, the Agencies estimate that approximately 50 banks annually would use the de minimis exclusion in proposed Exchange Act Rule 723 and each such bank would, on average, need to maintain records with respect to 10 trust or fiduciary accounts annually conducted in the exercise of the banks' trust or fiduciary responsibilities. Therefore, the Agencies estimate that proposed Exchange Act Rule 723 would result in approximately 500 accounts annually for which records are required to be maintained. The Agencies anticipate that these records would consist of records that are generally created as part of the securities transaction and the account relationship and minimal additional time would be required in maintaining these records. Based on this analysis, the Agencies estimate that a bank would spend approximately 15 minutes per account to comply with the record maintenance requirement of proposed Exchange Act Rule 723. Thus, the estimated total annual reporting and recordkeeping burden for proposed Exchange Act Rule 723 is 125 hours.

The Agencies believe that banks generally sweep or invest their customer funds into no-load money market funds. Accordingly, the Agencies estimate that approximately 500 banks annually would use the exemption in proposed Exchange Act Rule 741 and each bank, on average, would deliver the prospectus required by the proposed rule to approximately 1,000 customers annually. Therefore, the Agencies estimate that proposed Exchange Act Rule 741 would result in approximately 500,000 disclosures per year. The Agencies estimate further that a bank would spend approximately 5 minutes per response to comply with the delivery requirement of proposed Exchange Act Rule 741. Thus, the estimated total annual reporting and recordkeeping burden for proposed Exchange Act Rule 741 is 41,667 hours.

The Agencies propose that the information collections and burden estimates discussed above will be associated with the Board for banks and with the Commission for brokers or dealers.

13. Estimate of Total Annualized Cost Burden

Not applicable; (a) it is not anticipated that respondents will have to incur any capital or start up cost to comply with the proposed rules; (b) it is not anticipated that the respondents will have to incur any additional operational or maintenance cost (other than provided for in item no. 12) to comply with the proposed rules.

14. Estimate of Cost to Federal Government

Not applicable.

15. Explanation of Changes in Burden

Not applicable; proposed Rules 701, 723, and 741 would be new rules.

16. Information Collections Planned for Statistical Purposes

Not applicable; there is no intention to publish the information for any purpose.

17. Explanation as to why Expiration Date will not be displayed

Not applicable.

18. Exceptions to Certification

Not applicable.

B. Collection of Information Employing Statistical Methods

The collections of information do not employ statistical methods, nor would the implementation of such methods reduce burden or improve accuracy of results.