COMMISSION PROPOSES REGULATION B TO GOVERN BROKER EXCEPTIONS FOR BANKS: LITTLE IMPROVEMENT ON 2001 INTERIM RULES

The Securities and Exchange Commission has published proposed Regulation B implementing the bank exceptions from the definition of "broker" in the Securities Exchange Act of 1934 (the "Exchange Act"), added in 1999 in the Gramm-Leach-Bliley Act, which terminated the blanket exception for banks. See the *Federal Register* for June 30, 2004. The proposed rules, when adopted, will replace the interim final rules the Commission adopted on May 11, 2001. The interim rules never have been allowed to operate, because a temporary blanket exception for banks has been extended several times, with the effect of preempting them; currently the temporary blanket exception expires on November 12, 2004. The announcement of the interim rules elicited vigorous protest from the banking industry and it has taken the Commission over three years to develop this new proposal. Comments are due by August 2, 2004.

The Commission's Release No. 34-49879 announcing the proposed rules, published on June 17, corrected on June 18, and corrected again on June 23, can be found on its website at http://www.sec.gov/rules/proposed/34-49879.htm or at 69 Fed. Reg. 39682. (The final, corrected release contains some substantive changes from the initial version.)

The end is in sight for the blanket exception for banks from the definition of "broker" in the Exchange Act. (The provisions of Subtitle A, Title II of the Gramm-Leach-Bliley Act were called "push-out" provisions because they were intended to push most brokerage activities out of the bank.) The proposed rules will extend the blanket exception for banks until January 1, 2006. If the Commission adopts a final rule by the end of this year, banks will have one year to install compliance systems.

Proposed Rules

The Commission proposes three new special exemptions. (We use the word "exceptions" in this memorandum to refer to the statutory exceptions from the definition of "broker," as does the Commission, and we use the word "exemptions" to refer to exemptions created by the proposed rules that afford relief from certain conditions of the statutory exceptions.) One new exemption is for transactions in money market funds when the bank is acting for qualified investors (see below) or when it is acting in a fiduciary capacity or in the capacity of an escrow agent, collateral agent, depository agent, or paying agent. Another exemption is for transactions in mutual fund shares in certain tax-deferred plans, including 401(k) plans, for which the bank acts as trustee or custodian. The third exemption is for transactions abroad for foreign persons under Regulation S. These special exemptions appear to be useful and welcome.

There is little more good news. Banks will be disappointed if they expected to find any new liberality in the definitions and exemptions implementing the networking exception, the trust and fiduciary exception, the sweep exception, the exception for transactions with affiliates, or the custody activities exception. The new implementing exemptions under the trust and fiduciary exception, in particular, do not reflect any movement in the Commission's position in the interim rules.

Other highlights (if the proposed rules are adopted):

- Banks will be unable to take orders in individual retirement accounts.
- A bank will have to administer its compliance with the "chiefly compensated" requirement of the trust and fiduciary exception on an *account-by-account basis* unless it is willing to give up most fees from mutual funds and broker-dealers in its trust business.
- Banks offering sweep programs in shares of money market funds that do not qualify as "no-load" under the interim rules will have to make a change; the Commission is sticking with its definition. A new exemption will help banks operating sweeps in trust accounts and in escrow and collateral accounts.
- Banks with "networking" arrangements with broker-dealers will find that the rules for paying referral fees to employees have become more restrictive.
- If it was not clear before, or if the continued extension of the temporary blanket exception has lulled banks into a sense of security, it is clear now: the operation of bank omnibus accounts for customers is finished. These programs must be shifted to broker-dealers.
- The exceptions for trust activities, for certain stock purchase plan activities, and for safekeeping and custody activities require that a bank direct trades in publicly traded securities to registered broker-dealers for execution (or effect them by internal cross trades). An interim rule permitted banks to use the mutual funds services of the National Securities Clearing Corporation instead. That rule, somewhat tightened up, continues as a special exemption.

The appendix to this memorandum sets forth in a comparative table summaries of the eleven statutory exceptions from the definition of "broker" in the Exchange Act, the 2001 interim rules implementing these exceptions (not all have implementing rules), and the proposed rules.

The Exceptions and the New Proposed Rules

Networking Exception. This exception permits banks to continue their networking arrangements with broker-dealers and to receive compensation from brokerage transactions effected by the broker-dealers, usually on bank premises. A bank may pay an employee (other than a qualified associated person of the broker-dealer) only a non-contingent "nominal one-time cash fee of a fixed dollar amount" for a referral of a bank customer to the broker-dealer. The proposed rules, if adopted, will loosen the constraints on referral fees in two ways. First, under the interim rules the fee was limited in amount to one hour of the referring employee's wages; now it is limited to the greater of (i) the referring employee's base hourly rate of pay (which facilitates the

computation for salaried employees), (ii) $15 adjusted for inflation from 1999 (approximately $17 today), or (iii) $25. The fixed amounts permit banks to offer referral fees without computations based on salaries or hourly wages. Second, a referral fee now may be contingent on whether the customer contacts the broker-dealer or keeps his appointment with the broker-dealer and on whether the customer has assets or net worth meeting a general requirement for the program established by the bank or the broker-dealer.

The referral fee constraints are tightened in other ways, largely as a result of the staff becoming aware of bank practices it finds questionable. It is made clear now that "one-time" means one-time only (per customer). The interim rules permitted a referral fee of points in a bonus program covering a range of bank products and non-securities-related services, so long as the points awarded for referrals would not exceed the points awarded for non-securities-related activities. The proposed rules tighten up the points alternative. The points now must have a readily ascertainable cash value. The total fee—cash, if any, and points—must not exceed the amount limitation discussed above. The bonus program now must cover a broad range of products and must reward primarily non-securities-related activities.

Banks did not gain much in the proposed rules for their networking programs.

Trust and Fiduciary Exception. This exception was the main focus of bankers' comments on the interim rules; the Release devotes eighteen pages to discussion of comments on and explanation of the proposed rules implementing the exception. Under the statutory exception, a bank relying on this exception must be "chiefly compensated" on the basis of administrative or annual fees, percentage-of-assets-under-management fees, and flat or capped per order processing fees that do not exceed the bank's actual execution costs. The interim rules required banks to determine whether they were satisfying this condition annually on an account-by-account basis. The determination involves dividing the bank's compensation into "good" compensation, called *relationship compensation*, and "bad" compensation, called *sales compensation*.

- *Relationship compensation* includes the typical trust account fees a bank receives from *its customers* described above.
- *Sales compensation* includes fees a bank receives in connection with its trust and fiduciary activities from *other sources*, such as payments from broker-dealers for order flow, finder's fees from broker-dealers, service fees from mutual funds, 12b-1 fees from mutual fund distributors or other fees received from persons other than trust customers or beneficiaries. It also includes fees received from trust customers for effecting securities transactions that exceed the fees paid to the registered broker-dealers to which the transactions were directed.

Under the interim rules, a bank satisfied the "chiefly compensated" requirement in an account if the bank's relationship compensation in the account exceeded its sales compensation in the account for the period. The interim rules provided two exemptions: one for banks that receive less than 10% of their compensation for covered trust and fiduciary activities in sales compensation in the previous year and one for banks acting as indenture trustees investing in no-load money market funds.

The only significant change in the "chiefly compensated" requirement in the proposed rules is a subtle one. The interim rules defined *relationship compensation* to include fees for services for the provision of which the bank *relies on the trust exception*, received directly from the customer or beneficiary or from trust assets, that are (i) annual or administrative account fees or account fees based on a percentage of assets under management, and (ii) flat or capped per order processing fees not exceeding the bank's execution cost. The new definition excludes the restriction to services requiring the bank to rely on the trust exception, so that the bank now may include in relationship compensation fees for managing real estate assets and other property (which services do not require an exception from the definition of "broker"). Other than this, the "chiefly compensated" requirement itself is not significantly changed. (Rules for allocation among accounts of 12b-1 fees and fees received from other persons are included in the proposed rules.)

Rule 721. The proposed rules will govern how banks determine whether they have satisfied the "chiefly compensated" requirement. This important aspect of the interim rules drew heavy criticism. The Commission suggests that it is now providing a "line-of-business" approach to the "chiefly compensated" determination, but it is merely expanding the exemption in the interim rules for banks that received *less than 10% of their compensation for covered trust and fiduciary activities in sales compensation* in the previous year.

Under proposed Rule 721, if adopted, a bank may make *this* determination (that is, whether during the prior year it received less than 10% of its compensation for covered trust and fiduciary activities in sales compensation) either on a bank-wide or a line-of-business basis. The bank must satisfy the other conditions of the trust exception (that is, act in a trustee or fiduciary capacity, in the trust department, not publicly advertise brokerage services, and refer transactions to a registered broker-dealer, except for permitted cross trades) and it must have procedures, first, to ensure that when it opens a trust account it is likely to receive more relationship compensation from the account than sales compensation and, second, that, if it negotiates with the accountholder or beneficiary to increase the proportion of sales compensation after the account is opened, it again ensures that it is likely to receive more relationship compensation from the account than sales compensation.

The exemption needs, and has, a back-up exemption also. If the bank fails to meet the less-than-10% requirement one year, it may continue to rely on the exemption the next year if it can demonstrate that it received less than 14.3% of its compensation for covered trust and fiduciary activities in sales compensation in that year. It can rely on this back-up exemption only once every six years.

The logic here is not obvious. The Commission concedes that being "chiefly compensated" requires only that more "good" compensation be received than "bad" compensation, that the one outweigh the other. Moreover, it is hardly clear that the statute requires an account-by-account approach—in fact, the statute is more naturally read to require the bank to look at all its compensation for trust and fiduciary activities:

> The bank effects transactions . . . in its trust department . . . and is chiefly compensated for such transactions [that is, one supposes, *all* such covered transactions] . . . on the basis of [relationship compensation].[1]

In the interim rules the Commission adopted an account-by-account approach for the "chiefly compensated" determination—the definition of "chiefly compensated" applied to *an account*. There was widespread criticism. Now, again, the Commission excuses banks from the account-by-account approach, provided that their "good" compensation exceeds their "bad" compensation by *nine times*. The Commission is redefining "chiefly compensated" to require 90% good compensation as a condition of permitting banks to make the "chiefly compensated" determination on a line of business basis. This is bad news for banks that wish to accept fees from persons other than their trust customers.

Rule 722. There is in the proposed rules a series of new fall-back exemptions for banks that take the account-by-account approach. The problem is that a bank cannot know until after the end of each year whether it has complied with the "chiefly compensated" condition for an account during that year. Thus, the first exemption in the Rule 722 series exempts a bank from the "chiefly compensated" condition in an account if it can demonstrate that it satisfied the condition in the account during the preceding year. As was required for the Rule 721 exemption, though, the bank will have to have procedures to ensure that, first, when it opens a trust account it ensures that it is likely to receive more relationship compensation from the account than sales compensation and, second, if it negotiates with the accountholder or beneficiary to increase the proportion of sales compensation after the account is opened, it again ensures that it is likely to receive more relationship compensation from the account than sales compensation. The bank must satisfy the other conditions of the exception.

What if a bank fails to meet the "chiefly compensated" condition in an account for a given year? It may not know until the following year, and then during the current year it no longer has the benefit of the back-up exemption just discussed. There is a fall-back exemption for such a bank, but, as for the fall-back exemption under Rule 721, it can rely on the fall-back exemption for an account only once in six years.

There is a further fall-back exemption for a bank that has relied on the first fall-back exemption for an account during the preceding five years. It must (i) document the reason that the account continued not to meet the "chiefly compensated" condition and link that reason to its exercise of fiduciary responsibility and (ii) have relied on either of the Rule 722 fall-back exemptions during the five preceding years for no more than the lesser of (*a*) 500 or (*b*) 1% of the total number of its trust or fiduciary accounts. Further, a bank may not rely on either fall-back exemption under Rule 722 if more than 10% of the total number of its trust or fiduciary accounts did not meet the "chiefly compensated" condition (presumably during the year in question).

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[1] Exchange Act § 3(a)(4)(B)(ii).

Other Trust Exemptions. If the proposed rules are adopted, two additional exemptions will be available to banks for their trust and fiduciary activities. Rule 723 continues unchanged an exemption in the interim rules for a bank that satisfies the conditions of the statutory trust and fiduciary exception except for the "chiefly compensated" condition and effects transactions in no-load money market funds as an indentured trustee. There is a new grandfather exemption in Rule 720 for a bank that satisfies the conditions of the statutory trust and fiduciary exception except for the "chiefly compensated" condition and effects securities transactions in a living, testamentary or charitable trust account established no later than *July 30, 2004*, so long as the bank does not negotiate individually with the accountholder or beneficiary to increase the proportion of sales compensation in the account. The Commission also has introduced a new exemption (Rule 776) that applies to banks acting in a trustee or fiduciary capacity (and also in an escrow agent, collateral agent, depository agent or paying agent capacity) for transactions in money market fund shares, *whether or not no-load*. See below under "New Exemptions."

Individual Retirement Accounts. An IRA may be created through a custodial relationship with a bank. As a custodian, the bank has no discretionary responsibility, however, and the Commission believes it is not acting as a fiduciary. The interim rules defined the term "trustee capacity" for purposes of the trust activities exception to include acting as an IRA *trustee* (not merely a custodian). The definition will be withdrawn if the proposed rules are adopted, but no broadening of the concept of "trustee capacity" is implied. A bank acting as an IRA custodian may rely on the safekeeping and custody activities exception, as discussed below, but this exception does not cover accepting orders for the purchase and sale of securities.

Sweep Exception. This exception, which is important to banks and to money market funds, is intended to except banks from the definition of "broker" when they sweep idle funds out of bank deposit accounts daily into shares of no-load money market funds, and then sweep the funds back into the deposit accounts as needed to cover withdrawals. The goal is two-fold—to obtain interest for the customer that is greater than the bank can or will pay (and to obtain fees for the bank) and to avoid or reduce reserves required to be posted on funds in the deposit accounts. In the interim rules the Commission based the definition of "no-load" on the existing NASD definition and so for purposes of this exception a money market fund was no-load only if:

- purchases of its shares were not subject to a sales load or a deferred sales load, and
- total charges against assets to provide for sales and sales promotion expenses, personal services, and the maintenance of shareholder accounts (including but not limited to 12b-1 fees) did not exceed 25 basis points of average net assets annually and were disclosed in the fund's prospectus.

Some money market funds employed in bank sweep programs do not satisfy this definition and there were many comments asking for a broader definition. The Commission is sticking to its guns here, however; there are no significant changes in the proposed rules. The new exemption for transactions in money market fund shares, *whether or not no-load*, will be useful for banks operating sweeps in a trust or fiduciary capacity. See below under "New Exemptions."

Affiliate Transactions Exception. The proposed rules, if adopted, will have the effect of tightening up this exception. The interim rules did not include a specific rule on this exception, but the Commission's explanatory comments in its release made clear that the exception does not cover a trade with an unaffiliated customer, even if an affiliate is involved. Apparently, commenters not only failed to convince the Commission of a need to broaden the exception, they prompted it to propose a more restrictive rule that interprets the term "effects transactions for the account of any affiliate" to mean effecting transactions as agent for an affiliate of the bank (as defined in section 2 of the Bank Holding Company Act of 1956, as amended—the "BHC Act"), provided that:

(a) the affiliate is acting as a principal or as a trustee or fiduciary purchasing or selling for investment purposes;

(b) the affiliate is not (i) acting as a riskless principal for another person, (ii) a registered broker-dealer, or (iii) engaged in merchant banking (as described in section 4(k)(4)(H) of the BHC Act); and

(c) the bank obtains the securities to complete the transaction (i) from a registered broker-dealer, (ii) from a person acting in the capacity of a broker-dealer that is not required to register as such, or (iii) pursuant to another exception or exemption from the definition of "broker."

Under the proposed rules, if adopted, a bank wishing to obtain from a client, perhaps a commercial borrower, certain securities that its affiliate desires to purchase may not make an offer for the securities to its customer as agent of its affiliate.

Custody Activities Exception. Banks may be disappointed with the implementation of this statutory exception, which permits a bank to—

(a) provide safekeeping or custody services for securities, including exercising warrants and other rights for customers;

(b) facilitate transfers of funds or securities, as a custodian or clearing agency, in connection with the clearing or settling of customer securities transactions;

(c) effect securities lending or borrowing transactions with or for customers, as part of services provided described in (a) or (b) or invest cash collateral pledged in connection with such transactions;

(d) hold securities pledged by customers to other persons or securities subject to purchase or resale agreements involving customers, or facilitate the pledging or transfer of such securities, if the bank maintains records separately identifying the securities and the customer; or

(e) act as custodian or provider of related administrative services to an IRA or pension, retirement, profit sharing, bonus, thrift savings, incentive or similar benefit plan.

The statutory exception does not allow a custodian bank to take orders for securities transactions. The interim rules provided an exemption to allow a bank to effect securities transactions in a custody account, largely on an accommodation basis—the bank could receive no compensation, directly or indirectly, other than reimbursement for the broker-dealer's charge for execution, and there were limitations on bank employees effecting such transactions. The bank could not advertise the service. If the bank made available shares of mutual funds affiliated with the bank, it was required also to make available shares of similar but unaffiliated mutual funds.

The Commission now proposes to restrict this exemption (Rule 760), although it does relax the exemption by eliminating the requirement that the bank make available shares of similar but unaffiliated mutual funds when it makes available shares of mutual funds affiliated with the bank. Also, the bank now may receive 12b-1 and similar fees and the restrictions on its employees are relaxed somewhat. The bank now may rely on this exemption, however, only when effecting transactions for (i) customers who opened their accounts prior to *July 30, 2004*, and (ii) *qualified investors*.[2] The advertising ban continues, of course. The bank may not rely on this exemption for a trust account or an account for certain tax-deferred plans, including 401(k) plans. (There is a new exemption for transactions in such tax-deferred plans, discussed below under "New Exemptions.") The bank may not rely on this exemption if it is relying on the small bank exception at all. If the bank makes mutual fund shares available and receives 12b-1 fees, it must make available on the same terms every class of the mutual fund's shares it can obtain. An account in which the bank relies on this exemption must be subject to a written agreement providing for fees, and the bank's rights and obligations regarding (i) acting as custodian for an IRA or (ii) safekeeping, settling trades, investing cash balances as directed, collecting income, processing corporate actions, pricing securities positions and providing recordkeeping and reporting services.

Section 3(a)(4)(C) Condition. Section 3(a)(4)(C) of the Exchange Act requires a bank relying on certain exceptions from the definition of "broker" to direct to a registered broker-dealer any trade in a publicly traded security except (i) a cross trade or similar trade made by the bank or between the bank and an affiliated fiduciary consistently with applicable fiduciary principles or (ii) a trade permitted under rules or orders of the Commission. The condition applies to the trust and fiduciary exception, the exception for transactions incident to transfer agency services for certain plans and programs and the custody activities exception. In addition, the Commission proposes to include the section 3(a)(4)(C) condition in the various exemptions for trust and fiduciary activities, the custody services exemption for grandfathered accounts and accounts for qualified investors, the custody services exemption for small banks, and the new exemption for mutual fund transactions in certain tax-deferred plans.

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[2] *Qualified investors* are institutional investors such as investment companies, hedge funds, banks, savings associations, broker-dealers, insurance companies, some state employee benefit plans, ERISA employee benefit plans in which investment decisions are made by plan fiduciaries, governmental entities, companies with $25 million in investments, and natural persons with $25 million in investments. See appendix.

The Commission proposes to continue an exemption from this condition. Under proposed Rule 775, a bank that satisfies the conditions for an exception or exemption other than the requirement that it direct the trade to a registered broker-dealer is exempt from that requirement to the extent that it effects a transaction in securities of a mutual fund that is not exchange-traded (i) through FundServ (the NSCC's mutual fund service) or (ii) directly with the mutual fund's transfer agent, which must not receive 12b-1 or similar compensation for the distribution of securities. The exemption requires that the mutual fund securities be distributed by a registered broker-dealer, as virtually all mutual fund securities are, or that they bear a sales charge no greater than permitted for a registered broker-dealer under NASD rules.

New Exemptions

Exemption for Money Market Fund Transactions for Certain Investors. The Commission is introducing a new exemption (Rule 776) for transactions in shares of money market funds, *whether or not no-load*. The exemption is restricted as follows:

(a) The customer is a *qualified investor* (see note above) or a person that directs transactions from the cash flows of as asset-backed security with a minimum original asset value of $25 million;

(b) The bank acts in a trustee or fiduciary capacity; or

(c) The bank acts in the capacity of an escrow agent, collateral agent, depository agent or paying agent.

In each case, the bank may not characterize the shares as no-load unless the class of shares is no-load and, for customers in the (b) and (c) categories, at the time the customer authorizes it to effect transactions the bank must provide a prospectus and a notice that (i) discloses payments the bank may receive from the fund, the sponsor or trustee of the fund, another fund in the family, an agent of the fund, the fund's investment adviser, or any other affiliated person of the fund, (ii) identifies any such payments that are sales loads, deferred sales loads or 12b-1 fees, and (iii) advises the customer to read the prospectus carefully for additional information about expenses.

This exemption will not apply to sweeps operated by a bank for consumers unless the bank is acting in a trustee or fiduciary capacity. The exemption will provide welcome relief from the restrictions of the sweep exemption, however, where the customers are qualified investors or the bank is acting in one of the permitted capacities (which do not include acting as an IRA custodian).

Exemption for Tax-deferred Plan Transactions. Another new exemption in the proposed rules (Rule 770), if adopted, will permit a bank to effect transactions in mutual fund shares in certain tax-deferred plans, including 401(k) plans (specifically, plans qualified under section 401(a) or described in sections 403(b) or 457 of the Internal Revenue Code) for which the bank acts as trustee or custodian or offers plan participants a participant-directed brokerage account. This exemption will be independent of the trust and fiduciary exception and will allow banks to avoid the "chiefly compensated" condition of that exception in some of their 401(k) business. The bank must satisfy the following conditions:

(a) The bank credits any compensation it receives from a fund complex related to securities in which plan assets are invested against fees and expenses that the plan owes to the bank;

(b) The bank provides a clear and conspicuous disclosure to the plan sponsor or its designated fiduciary that includes all fees and expenses for services to the plan and all compensation received or to be received from a fund complex in a manner that permits the determination that the bank has credited all compensation received from a fund complex related to securities in which plan assets are to be invested against fees and expenses that the plan owes to the bank;

(c) The bank offers the participant-directed brokerage account through a registered broker-dealer;

(d) The bank does not pay any incentive compensation to an individual not qualified under NASD rules that varies based on the value or type of security purchased or sold in an account; and

(e) The bank complies with section 3(a)(4)(C) (effects transactions through a registered broker-dealer).

Exemption for Regulation S Transactions. Bankers can thank the Institute of International Bankers for this new exemption (Rule 771), which permits sales and resales of securities under Regulation S to and from non-U.S. persons (or, in some circumstances, registered broker-dealers). The exemption permits a bank, acting as agent or riskless principal, to—

(a) effect a sale of an *eligible security* to a non-U.S. person who is outside the United States in compliance with Rule 903 under Regulation S;

(b) effect a resale of an eligible security, after its initial sale in compliance with Rule 903 under Regulation S, by or on behalf of a non-U.S. person to a non-U.S. person or a registered broker-dealer, provided that, if the sale is made before the distribution compliance period expires, it is made in compliance with Rule 904 under Regulation S; or

(c) effect a resale of an eligible security, after its initial sale in compliance with Rule 903 under Regulation S, by or on behalf of a registered broker-dealer to a non-U.S. person, provided that, if the sale is made before the distribution compliance period expires, it is made in compliance with Rule 904 under Regulation S.

An *eligible security* is a security that (i) is not being sold from the inventory of the bank or an affiliate and (ii) is not being underwritten by the bank or an affiliate on a firm commitment basis, unless the bank acquired the security from an unaffiliated distributor that did not purchase it from the bank or an affiliate. A non-U.S. person is a person who is not a *U.S. person* under section 902(k) of Regulation S (see appendix). The exemption is for transactions abroad, with non-U.S. persons or registered broker-dealers. It will permit domestic and foreign banks to act for foreign persons in the Regulation S market.

Other Exceptions

There are other statutory exceptions for which the Commission has not proposed rules. These are the exceptions in section 3(a)(4)(B) under subparagraphs (iii) (for transactions in commercial paper, banker's acceptances, commercial bills, exempted securities (i.e., government securities and municipal securities), Canadian government securities, North American Development Bank obligations, and standardized credit-enhanced Brady bonds); (iv) (for transactions incident to transfer agency services for retirement and benefit plans, dividend reinvestment plans and other issuer programs); (vii) (for transactions as part of a private securities offering under sections 3(b), 4(2) or 4(6) of the Securities Act of 1933); (ix) (for transactions in *identified banking products*—deposit accounts, banker's acceptances, bank letters of credit and loans, debit accounts arising from credit cards, participations in loans held by the bank or an affiliate sold to qualified investors and swaps, including equity swaps sold to qualified investors); (x) (for transactions in municipal securities); and (xi) (the de minimis exception for up to 500 transactions per calendar year not covered by another exception). In addition, there are exemptions for savings associations and for credit unions that are beyond the scope of this memorandum.

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APPENDIX: SECURITIES BROKERAGE TRANSACTIONS PERMISSIBLE FOR A BANK WITHOUT REGISTRATION AS A BROKER-DEALER ("BD") **("1940 Act" = Investment Company Act of 1940)**

Statutory Exceptions in § 3(a)(4)(B) of Exchange Act	Interim Rules (2001)	Regulation B (Proposed)
(i) NETWORKING EXCEPTION. TRANSACTIONS FOR CUSTOMERS THROUGH A CONTRACTUAL NETWORKING ARRANGEMENT WITH A REGISTERED BD, *PROVIDED THAT*— (a) THE BD IS IDENTIFIED AS PROVIDER OF BROKERAGE SERVICES AND PERFORMS SERVICES IN CLEARLY MARKED AND SEPARATE AREA, (b) THE BANK'S PROMOTIONAL MATERIALS IDENTIFY THE BD AS PROVIDING THE BROKERAGE SERVICES AND COMPLY WITH FEDERAL SECURITIES LAWS, (c) ANY BANK EMPLOYEE NOT A QUALIFIED ASSOCIATED PERSON OF THE BD PERFORMS ONLY CLERICAL FUNCTIONS AND RECEIVES NO INCENTIVE COMPENSATION EXCEPT A REFERRAL FEE THAT IS A NON-CONTINGENT "NOMINAL ONE-TIME CASH FEE OF A FIXED DOLLAR AMOUNT," (d) CUSTOMERS RECEIVING BROKERAGE SERVICES ARE FULLY DISCLOSED TO THE BD, (e) THE BANK DOES NOT CARRY CUSTOMER SECURITIES ACCOUNTS (EXCEPT AS PERMITTED UNDER EXEMPTIONS (ii) OR (viii)), AND (f) THE BANK OR BD INFORMS EACH CUSTOMER THAT BROKERAGE SERVICES ARE PROVIDED BY THE BD, AND NOT BY THE BANK, AND THAT SECURITIES ARE NOT DEPOSITS OR OBLIGATIONS OF THE BANK, ARE NOT GUARANTEED BY THE BANK AND ARE NOT INSURED BY THE FDIC.	**RULE 3b-17(g).** *Nominal one-time cash fee of a fixed dollar amount* means a payment— (a) not exceeding 1 hour of the referring employee's wages *or* (b) of points counting toward a bonus in a program covering a range of bank products and non-securities-related services if the points awarded for the referral do not exceed the points awarded for non-securities-related activities, that is not related to the size, value or completion of any securities transaction, the amount of securities-related assets gathered, the size of any customer's bank or securities account, or the customer's financial status. **RULE 3b-17(h).** *Referral* applies to a bank employee arranging for a BD a first-time contact with a bank customer.	**RULE 242.710.** The term "nominal one-time cash fee of a fixed dollar amount" means a payment— (a) not exceeding the *greater* of (1) the referring employee's base hourly rate of pay, (2) $15 adjusted for inflation from 1999 (approximately $17 in 2004) or (3) $25; (b) paid no more than one time for each customer referred; (c) that, to the extent not in cash, (1) is paid in units of value with readily ascertainable cash equivalent, (2) together with any cash portion, has a total cash value that complies with (a), and (3) is paid under an incentive program that covers a broad range of products and that is designed primarily to reward activities unrelated to securities; and (d) does not vary based on the customer's financial status, the identity of the BD to which the customer is referred, whether the customer expresses an interest in any particular type of security, or the number of referrals the employee makes. A referral fee must be non-contingent, that is not contingent on whether a transaction or particular type of transaction results or is likely to result or whether multiple transactions result. A referral fee may be contingent on whether the customer (1) contacts or keeps an appointment with the BD or (2) has assets, net worth or income meeting an established general requirement.
(ii) TRUST AND FIDUCIARY EXCEPTION. TRANSACTIONS EFFECTED IN A TRUSTEE OR FIDUCIARY CAPACITY IN THE TRUST DEPARTMENT (OR OTHER DEPARTMENT REGULARLY EXAMINED BY BANK EXAMINERS FOR COMPLIANCE WITH FIDUCIARY STANDARDS), *WHERE*— (i) THE BANK IS "CHIEFLY COMPENSATED" BY AN ANNUAL FEE, AN ASSET-BASED FEE, OR A "FLAT OR CAPPED PER-ORDER PROCESSING FEE NOT EXCEEDING THE BANK'S EXECUTION COST," OR ANY COMBINATION THEREOF, AND (ii) THE BANK DOES NOT PUBLICLY SOLICIT BROKERAGE BUSINESS OTHER THAN BY ADVERTISING ITS TRUST SERVICES.✱	**RULE 3b-17(a).** The *chiefly compensated computation* is account-by-account, done annually. When all compensation has been identified as *unrelated compensation*, *relationship compensation* or *sales compensation*, after unrelated compensation is set aside, relationship compensation must exceed sales compensation in the account for the preceding calendar or fiscal year consistently used by the bank.	**CHIEFLY COMPENSATED—RULE 242.724(a).** The term means that during the preceding year the bank received more relationship compensation than sales compensation from a trust or fiduciary account. **YEAR—RULE 242.724(j).** The term means a calendar year or other fiscal year consistently used by the bank for recordkeeping and reporting purposes.
FOR PURPOSES OF THE TRUST EXCEPTION, "TRUST OR FIDUCIARY ACCOUNT" MEANS "ACCOUNT FOR WHICH THE BANK ACTS IN A TRUSTEE OR FIDUCIARY CAPACITY."		

✷§ 3(a)(4)(C) APPLIES. THE EXCEPTIONS FROM THE DEFINITION OF "BROKER" IN SECTIONS 3(a)(4)(B)(ii), (iv) AND (viii) ARE NOT APPLICABLE IF ACTIVITIES RESULT IN *A TRADE IN THE U.S. IN A PUBLICLY TRADED SECURITY* UNLESS: (i) THE BANK DIRECTS THE TRADE TO A REGISTERED BD FOR EXECUTION, (ii) THE TRADE IS A CROSS TRADE BY THE BANK OR BETWEEN THE BANK AND AN AFFILIATED FIDUCIARY CONSISTENT WITH FEDERAL AND STATE FIDUCIARY LAWS, OR (iii) SEC RULES OR ORDERS PERMIT THE TRADE.		
	RULE 3a4-6. *Exemption for Transactions Effected through NSCC or with Transfer Agent.* A bank that meets the conditions for an exception or exemption from the definition of "broker" except for the condition in § 3(a)(4)(C)(i) is exempt from such condition for transactions in mutual fund shares effected through the NSCC's Mutual Fund Services.	**EXEMPTION FOR TRANSACTIONS EFFECTED THROUGH NSCC OR WITH TRANSFER AGENT—RULE 242.775**. A bank that meets the conditions for an exception or exemption from the definition of "broker" except for the condition in § 3(a)(4)(C)(i) is exempt from such condition to the extent that it effects transactions in securities of a mutual fund that is not exchange-traded if: (1) the transactions are effected through the NSCC's Mutual Fund Services or directly with the fund's transfer agent; (2) the transfer agent, if any, does not accept compensation for distribution of the securities (including 12b-1 fees and similar compensation); and (3) the mutual fund securities are distributed by a registered BD or the sales charge is no greater than the amount a registered BD may charge under NASD rules.
DEFINITION OF "FIDUCIARY CAPACITY" §3(a)(4)(D)— (a) IN THE CAPACITY AS TRUSTEE, EXECUTOR, ADMINISTRATOR, REGISTRAR OF STOCKS AND BONDS, TRANSFER AGENT, GUARDIAN, ASSIGNEE, RECEIVER, CUSTODIAN UNDER A UNIFORM GIFTS TO MINORS ACT, OR INVESTMENT ADVISER IF THE BANK RECEIVES A FEE FOR ITS INVESTMENT ADVICE, (b) IN ANY CAPACITY IN WHICH THE BANK EXERCISES INVESTMENT DISCRETION ON BEHALF OF ANOTHER, OR (c) IN ANY OTHER SIMILAR CAPACITY.	**RULE 3b-17(k).** *Trustee capacity* includes acting as indenture trustee and trustee for a tax-deferred account under sections 401(a), 408, 408A and 457 of the Internal Revenue Code. This does not include acting as an IRA trustee. Transfer agent capacity does not cover securities transactions effected *for investors*. "Congress intended that banks act in a 'strict trustee or fiduciary capacity' that provides investors the protection of strong fiduciary principles if conducting securities activities without BD registration" under this exception. A bank acts *as a transfer agent* (as defined in § 3(a)(25)) only when it acts *on behalf of an issuer*, and not when it acts *on behalf of an investor*.	Definition and commentary in interim rules withdrawn. Nevertheless, commentary makes clear that "trustee capacity" includes only strict fiduciary capacities, not capacities such as IRA custodian or transfer agent.
	RULE 3b-17(d). *Investment adviser if the bank receives a fee for its investment advice* refers to a relationship between a bank and a customer in which the bank— (i) provides continuous and regular investment advice for a fee, based on the customer's individual needs, and (ii) owes a duty of loyalty to the customer under contract or state or federal law, including an affirmative duty of disclosure of all material facts relating to conflicts. This is not true of a non-discretionary account if the bank's responsibilities arise only when the customer places an order and terminate when the transaction is complete.	**INVESTMENT ADVISER IF THE BANK RECEIVES A FEE FOR ITS INVESTMENT ADVICE—RULE 242.724(d).** The term refers to a fiduciary relationship between a bank and a customer in which the bank— (i) has an on going responsibility to provide investment advice based on the customer's individual needs that includes making recommendations regarding specific securities and, if the customer accepts such recommendations, to direct the purchases or sales to a registered BD for execution (ii) owes a duty of loyalty to the customer, including an affirmative duty of disclosure of all material facts and conflicts of interest.

	RULE 3b-17(b). A *flat or capped per order processing fee not exceeding the bank's execution cost* is a fee no greater than a BD has charged the bank for executing the transaction *plus* the costs of bank resources solely dedicated to transaction execution, comparison and settlement for trust and fiduciary customers (may include salary of trust department employee whose sole responsibility is on a trading desk exclusively for trust or fiduciary customers, but not any part of salary of employee with other responsibilities and not any incentive-based compensation). A processing fee exceeding this is entirely excluded. Brokerage fees resulting in cash rebates or soft dollar benefits are excluded (except those resulting in payments for general research within § 28(e)).	**FLAT OR CAPPED PER ORDER PROCESSING FEE NOT EXCEEDING THE BANK'S EXECUTION COST—RULE 242.724(b).** The term means a fee no greater than a BD has charged a trust or fiduciary account for executing the transaction *plus* the direct marginal cost of any bank resources that are used for transaction execution, comparison or settlement for trust and fiduciary accounts, if the bank makes a precise and verifiable allocation of these resources according to their use.
	RULE 3b-17(i). *Relationship compensation* includes fees for services for which the bank relies on the trust exception, received directly from the customer or beneficiary or from trust assets, that are— (i) annual or administrative account fees or account fees based on a percentage of assets under management, and (ii) flat or capped per order processing fees not exceeding the bank's execution cost.	**RELATIONSHIP COMPENSATION—RULE 242.724(h).** The term means compensation a bank receives directly from the customer or beneficiary, or from trust assets, that consist solely of (i) annual or administrative account fees or account fees based on a percentage of assets under management, and (ii) flat or capped per order processing fees not exceeding the bank's execution cost.
	RULE 3b-17(j). *Sales compensation* includes— (i) a transaction fee that is not a *flat or capped per order processing fee not exceeding the bank's execution cost* (ii) compensation that, if paid to a BD, would be "payment for order flow" (i.e., payment of money or other benefit to a BD in return for the routing of customer orders to another BD for execution) (iii) a fee received for a securities transaction other than a finder's fee under the networking exception (iv) a fee paid for an offering of securities that is not received directly from a customer or beneficiary or from trust assets (v) a 12b-1 fee (vi) a service fee from an investment company for personal services or the maintenance of shareholder accounts.	**SALES COMPENSATION—RULE 242.724(i).** The term means compensation in connection with activities pursuant to the trust exception that is— (i) a transaction fee exceeding the *flat or capped per order processing fee not exceeding the bank's execution cost* (ii) compensation that, if paid to a BD, would be "payment for order flow" (i.e., payment of money or other benefit to a BD in return for the routing of customer orders to another BD for execution) (iii) a finder's fee received for a securities transaction or account other than a finder's fee under the networking exception (iv) a fee paid for an offering of securities that is not received directly from a customer or beneficiary or from trust assets[1] (v) a 12b-1 fee[2] (vi) a service fee from an investment company for personal services or the maintenance of shareholder accounts.[3]
		allocated to each account— [1]by *dividing* the number of shares of each class of an investment company's securities in the account on the last business day of the preceding year by the total number of such shares held by the bank in a trustee or fiduciary capacity on the same day *and multiplying* the resulting number by the total dollar amount of such fees received by the bank in connection with that class during the preceding year *or* by another allocation method that fairly and consistently measures the amount of sales compensation attributable to each account during the preceding year.

		[2]by *multiplying* the number of shares of each class of an investment company's securities in each account on the last business day of the preceding year by the net asset value per share for that class *or* by another allocation method that fairly and consistently measures the amount of sales compensation attributable to each account during the preceding year.
		[3]by *dividing* the number of shares of each class of an investment company's securities in each account on the last business day of the preceding year by the total number of such shares held by the bank in a trustee or fiduciary capacity on the same day *and multiplying* the resulting number by the total dollar amount of such fees received by the bank in connection with that class during the preceding year *or* by another allocation method that fairly and consistently measures the amount of sales compensation attributable to each account during the preceding year.
	The following charges are *not* charges for personal services or the maintenance of shareholder accounts: (a) transfer agent and sub-transfer agent services for beneficial owners of mutual fund shares; (b) aggregating and processing purchase and redemption orders; (c) providing account statements to beneficial owners showing their purchases, sales and positions in the investment company; (d) processing dividend payments for the investment company; (e) providing subaccounting services to the investment company for shares held beneficially; (f) forwarding shareholder communications to beneficial owners; and (g) receiving, tabulating and transmitting proxies from beneficial owners of investment company shares.	
	Unrelated compensation is neither relationship compensation nor sales compensation. It is not included in the "chiefly compensated" computation. Examples are fees charged separately for services unrelated to securities transactions, such as checking account fees, loan fees, fees for safekeeping of assets other than securities, etc., and compensation received pursuant to another BD registration exception, such as the networking exception.	Definition withdrawn (unnecessary).
		EXEMPTION FOR EXISTING LIVING, TESTAMENTARY OR CHARITABLE TRUST ACCOUNTS—RULE 242.720. A bank relying on the trust exception is exempt from meeting the "chiefly compensated" condition to the extent that it effects transactions for a living, testamentary or charitable trust account established before July 30, 2004, in a trustee or fiduciary capacity (see § 3(a)(4)(D) above), if the bank (a) meets the other trust exception conditions and (b) does not negotiate individually with the accountholder or beneficiary to increase the proportion of sales compensation as compared to relationship compensation after [same date].
	RULE 3a4-3. *Chiefly Compensated Computation Exemption For Bank Serving As Indenture Trustee*. A bank serving as an *indenture trustee* that invests idle funds in *no-load money market funds* (as defined in Rule 3b-17(e), discussed below) and complies with the requirements of the trust exception, except for the "chiefly compensated" requirement, is exempt from BD registration.	**CHIEFLY COMPENSATED COMPUTATION EXEMPTION FOR BANK SERVING AS INDENTURE TRUSTEE—RULE 242.723.** A bank that meets the conditions of the trust exception, except for the "chiefly compensated" condition, is exempt from the definition of "broker" to the extent that it effects transactions as an *indenture trustee* in a *no-load money market fund.*

		INDENTURE TRUSTEE—RULE 242.724(c). The term means any trustee for an *indenture* (i) to which the definition in section 303 of the Trust Indenture Act of 1939 applies or (ii) to which such definition would apply but for an exemption pursuant to section 304. **MONEY MARKET FUND—RULE 242.724(f).** The term has the same meaning as in § 242.740. **NO-LOAD—RULE 242.724(g).** The term has the same meaning as in § 242.740.
	RULE 3a4-2. *Chiefly Compensated Computation Exemption.* A bank that meets with the conditions of the trust exception, except for the "chiefly compensated" requirement, for which sales compensation is less than 10% of relationship compensation for the preceding year, is exempt without performing the "chiefly compensated" computation on an account-by-account basis, provided that the bank— (i) maintains procedures to ensure that it is chiefly compensated by relationship compensation in each fiduciary account (*a*) when the account is opened, (*b*) whenever the account compensation arrangements are changed, and (*c*) when the bank reviews account compensation for purposes of determining an employee's compensation; and (ii) complies with § 3(a)(4)(C).✷	**CHIEFLY COMPENSATED COMPUTATION EXEMPTION—BANK WIDE OR FOR LINES OF BUSINESS—RULE 242.721(a).** A bank relying on the trust exception is exempt from meeting the "chiefly compensated" condition to the extent that it effects securities transactions for any account in a trustee or fiduciary capacity in any year in which the bank— (a) meets the other conditions of the trust exception; (b) can demonstrate that during the preceding year its ratio of sales compensation to relationship compensation was no more than 1 to 9; (c) maintains procedures to review an account to ensure that it is likely to receive more relationship compensation than sales compensation in the account (i) before opening a trust or fiduciary account, and (ii) after opening a trust or fiduciary account, at any time that it negotiates individually with the accountholder or beneficiary to increase the proportion of sales compensation to relationship compensation.
		ADDITIONAL CHIEFLY COMPENSATED COMPUTATION EXEMPTION—BANK WIDE OR FOR LINES OF BUSINESS—RULE 242.721(b). A bank that fails to meet the ratio requirement of Rule 242.721(a) may continue to rely on Rule 242.721(a) if it (a) meets the other conditions of the trust exception; (b) can demonstrate that during the preceding year its ratio of sales compensation to relationship compensation was no more than one to seven; and (c) did not rely on this Rule 242.721(b) during any of the five preceding years.
		APPLICABILITY—RULE 242.721. A bank may rely on Rule 242.721 (i) on a bank-wide basis or (ii) for one or more lines of business provided that the sales compensation and relationship compensation from all trust or fiduciary accounts (or all trust or fiduciary accounts established before a specified date) within a particular line of business are used to determine whether the bank meets the ratio requirements of Rules 242.721(a) or 242.721(b).
		LINE OF BUSINESS—RULE 242.724(e). The term means an identifiable department, unit or division of a bank organized and operated on an ongoing basis for business reasons with similar types of trust or fiduciary accounts.

		EXEMPTION FROM ACCOUNT-BY-ACCOUNT DETERMINATION—RULE 242.722(a). A bank that relies on the trust exception is exempt from the "chiefly compensated" condition to the extent that it effects securities transactions for an account in a trustee or fiduciary capacity in any year in which it— (a) meets the other conditions of the trust exception; (b) can demonstrate that it met the "chiefly compensated" condition for such account during the preceding year; and (c) maintains procedures to review an account to ensure that it is likely to receive more relationship compensation than sales compensation in the account (i) before opening a trust or fiduciary account, and (ii) after opening a trust or fiduciary account, at any time that it negotiates individually with the accountholder or beneficiary to increase the proportion of sales compensation to relationship compensation.
		ADDITIONAL EXEMPTION FROM ACCOUNT-BY-ACCOUNT DETERMINATION—RULE 242.722(b). A bank that fails to meet the requirement of Rule 242.722(a) that it met the "chiefly compensated" condition with respect to an account during the preceding year may continue to rely on Rule 242.722(a) with respect to such account if it (a) meets the other conditions of Rule 242.722(a); and (b) did not rely on Rule 242.722(b) for such account during the five preceding years.
		FURTHER EXEMPTION FROM ACCOUNT-BY-ACCOUNT DETERMINATION—RULE 242.722(c). A bank that fails to meet the requirement of Rule 242.722(a) that it met the "chiefly compensated" condition with respect to an account during the preceding year *and* to meet the condition of Rule 242.722(b) that it did not rely on Rule 242.722(b) during any of the five preceding years with respect to such an account may continue to rely on Rule 242.722(b) with respect to such account if it— (a) meets the other conditions of Rule 242.722(a); (b) has documented the reason that such account continued not to meet the "chiefly compensated" condition and has linked that reason to its exercise of fiduciary responsibility; and (c) has no more than the lesser of (i) 500 or (ii) 1% of the total number of trust or fiduciary accounts for which it relied on Rule 242.722(b) during any of the five preceding years.
		APPLICABILITY—RULE 242.722. A bank may not rely on Rules 242.722(b) and (c) if more than 10% of the total number of trust or fiduciary accounts did not meet the "chiefly compensated" condition.
(iii) EXCEPTION FOR TRANSACTIONS IN CERTAIN SECURITIES. COMMERCIAL PAPER, BANKER'S ACCEPTANCES, COMMERCIAL BILLS, EXEMPTED SECURITIES (GOVERNMENT AND MUNICIPAL SECURITIES), CANADIAN GOVERNMENT SECURITIES, NORTH AMERICAN DEVELOPMENT BANK OBLIGATIONS, *AND* STANDARDIZED CREDIT-ENHANCED BRADY BONDS.	NO RULES.	

(iv) TRANSFER AGENCY ACTIVITIES EXCEPTION. TRANSACTIONS INCIDENT TO TRANSFER AGENCY SERVICES FOR AN ISSUER'S RETIREMENT & BENEFIT PLANS, DIVIDEND REINVESTMENT PLANS, OR OTHER PLANS FOR THE PURCHASE OR SALE OF ISSUER'S SHARES, *PROVIDED THAT* THE BANK DOES NOT SOLICIT TRANSACTIONS OR PROVIDE INVESTMENT ADVICE IN CONNECTION WITH THE PLAN, AND, IN THE CASE OF DIVIDEND REINVESTMENT PLANS AND OTHER ISSUER PLANS, THE BANK DOES NOT NET BUY AND SELL ORDERS (OTHER THAN FOR PROGRAMS WITH ODD-LOT HOLDERS OR REGISTERED PLANS).✱	NO RULES.	
(v) SWEEP EXCEPTION. TRANSACTIONS IN NO-LOAD MONEY MARKET FUNDS IN SWEEP ACCOUNTS	**RULE 3b-17(e).** A *money market fund* is an open-end registered management investment company that is regulated as a money market fund under Rule 2a-7.	**MONEY MARKET FUND—RULE 242.740(b).** The term means an open-end registered investment company that is regulated as a money market fund pursuant to Rule 2a-7.
	RULE 3b-17(f). A mutual fund is *no-load* if (i) purchases of its shares are not subject to a sales load or a deferred sales load and (ii) its total charges against net assets to provide for (*a*) sales or sales promotion expenses and (*b*) personal services or the maintenance of shareholder accounts do not exceed 25 basis points of average net assets annually and are disclosed in the mutual fund's prospectus. This does not prevent a bank from charging its customers a fee for sweep services, nor from effecting sweeps into a money market fund that charges more than 25 basis points under its 12b-1 plan—so long as it charges no more than 25 basis points for sales and sales-related expenses, personal services and the maintenance of shareholder accounts.	**NO-LOAD—RULE 242.740(c).** The term means, in the context of an investment company, for the class of securities in which a bank effects transactions, that (a) the class is not subject to a sales load or a deferred sales load; and (b) total charges against net assets of that class for (*a*) sales or sales promotion expenses, (*b*) personal services, or (*c*) the maintenance of shareholder accounts do not exceed 25 basis points of average net assets annually and are disclosed in the company's prospectus. See above list of charges that are *not* charges for personal services or the maintenance of shareholder accounts and here also are *not* charges for sales or sales promotion expenses.
		SALES LOAD—RULE 242.740(e). See section 2(a)(35) of the 1940 Act. **DEFERRED SALES LOAD—RULE 242.740(a).** See Rule 6c-10. **OPEN-END COMPANY—RULE 242.740(d).** See section 5(a)(1) of the 1940 Act.
(vi) AFFILIATE TRANSACTIONS EXCEPTION. TRANSACTIONS EFFECTED FOR THE ACCOUNT OF AN AFFILIATE OF THE BANK (OTHER THAN A BD OR MERCHANT BANKING AFFILIATE)	An "affiliate" of a company is another company that controls, is controlled by, or is under common control with the company. The exception does not cover a trade with an unaffiliated customer, even if effected as part of a trade with an affiliate. Under rule 15a-6(a)(4)(i) a foreign broker dealer may effect securities transactions, without becoming subject to U.S. broker dealer registration, with or for a U.S. bank acting in a BD capacity. If the foreign BD is an affiliate of a U.S. bank, the U.S. bank may act in a BD capacity, for purposes of the transaction with the foreign BD, in reliance on the exception for transactions with affiliates.	**EFFECTS TRANSACTIONS FOR THE ACCOUNT OF ANY AFFILIATE—RULE 242.750.** The term means effecting securities transactions as agent for an affiliate of the bank (as defined interim rules), provided that— (a) the affiliate is (i) acting as a principal, or (ii) acting as a trustee or fiduciary purchasing or selling for investment purposes; (b) the affiliate is not (i) acting as a riskless principal for another person, (ii) registered as a BD, or (iii) engaged in merchant banking (as described in section 4(k)(4)(H) of the Bank Holding Company Act); and (c) the bank obtains the securities to complete the transaction (i) from a registered BD, (ii) from a person acting in the capacity of a BD that is not required to register as such, or (iii) pursuant to another exception or exemption from the definition of "broker."

(vii) PRIVATE PLACEMENT EXCEPTION. TRANSACTIONS FOR OTHERS AS PART OF A PRIVATE SECURITIES OFFERING UNDER 1933 ACT §§ 3(b), 4(2) OR 4(6), *PROVIDED THAT*— (i) THE BANK IS NOT AFFILIATED AFTER NOV. 22, 2001, WITH A BD REGISTERED FOR MORE THAN 1 YEAR THAT ENGAGES IN DEALING, MARKET MAKING OR UNDERWRITING OF SECURITIES (OTHER THAN EXEMPTED SECURITIES), AND (ii) IF THE BANK IS UNAFFILIATED WITH A BD, THE BANK DOES NOT EFFECT ANY SUCH PRIVATE OFFERING OF AMOUNT EXCEEDING 25% OF THE BANK'S CAPITAL (OTHER THAN AN OFFERING OF GOVERNMENT OR MUNICIPAL SECURITIES).	NO RULES.	
(viii) CUSTODY ACTIVITIES EXCEPTION. AS PART OF CUSTOMARY BANKING ACTIVITIES, THE BANK— (a) PROVIDES SAFEKEEPING OR CUSTODY SERVICES FOR SECURITIES, INCLUDING EXERCISING WARRANTS AND OTHER RIGHTS FOR CUSTOMERS, (b) FACILITATES TRANSFERS OF FUNDS OR SECURITIES, AS A CUSTODIAN OR CLEARING AGENCY, IN CONNECTION WITH THE CLEARING OR SETTLING OF CUSTOMER SECURITIES TRANSACTIONS, (c) EFFECTS SECURITIES LENDING OR BORROWING TRANSACTIONS WITH OR FOR CUSTOMERS, AS PART OF SERVICES PROVIDED PURSUANT TO (a) OR (b) OR INVESTS CASH COLLATERAL PLEDGE IN CONNECTION WITH SUCH TRANSACTIONS,	**RULE 3a4-5.** A bank may effect securities transactions in an account for which the bank acts as custodian if— (1a) the bank is not compensated directly or indirectly for effecting such transactions (other than to be reimbursed for the BD's charge for execution), and (1b) the bank's annual compensation received for effecting such transactions is less than 3% of annual revenues; (2) any bank employee effecting such transactions (i) is not an associated person of a BD, (ii) has primary duties for the bank other than effecting securities transactions for customers, (iii) does not receive compensation from the bank that varies with (*a*) the size, value or completion of a transaction, (*b*) the amount of securities-related assets gathered, or (*c*) the size or value of any customer's securities account, and (iv) does not receive compensation from the BD for any customer referral;	**EXEMPTION FOR EXISTING CUSTODY ACCOUNTS AND QUALIFIED INVESTORS—RULE 242.760.** A bank is exempt from the definition of "broker" to the extent that it effects securities transactions for an account for which the bank acts as custodian (i) for a person with an account opened before July 30, 2004, or (ii) for a qualified investor (as defined in § 3(a)(54)(A)) if— (a) the bank does not charge or receive any compensation for effecting such transactions that varies on the basis of whether the bank accepts an order to purchase or sell a security, other than a 12b-1 fee or a fee paid by a registered investment company (other than a 12b-1 fee) for personal services or the maintenance of shareholder accounts; (b) a bank employee effecting the transactions does not receive compensation from the bank, the executing BD or any other person related to the size, value or completion of any such securities transaction; (c) the bank does not solicit such securities transactions except through responding to inquiries of a potential purchaser in a communication initiated by the potential purchaser if the response is limited to (i) information contained in a registration statement for the security, and (ii) sales literature prepared by the principal underwriter or by a registered investment company that is not an affiliated person of the bank;
(d) HOLD SECURITIES PLEDGED BY CUSTOMERS TO OTHER PERSONS OR SECURITIES SUBJECT TO PURCHASE OR RESALE AGREEMENTS INVOLVING CUSTOMERS, OR FACILITATE THE PLEDGING OR TRANSFER OF SUCH SECURITIES, IF THE BANK MAINTAINS RECORDS SEPARATELY IDENTIFYING THE SECURITIES AND THE CUSTOMER, OR (e) ACTS AS CUSTODIAN OR ADMINISTRATOR TO AN IRA OR PENSION, RETIREMENT, PROFIT SHARING, BONUS, SAVINGS, INCENTIVE OR SIMILAR BENEFIT PLAN,	(3) the bank does not solicit securities transactions except by (i) delivering advertising and sales literature prepared by the investment company's principal underwriter or by an investment company that is not an affiliated person, (ii) responding to inquiries from potential purchasers (limited to information in prospectus or such sales literature), (iii) advertising its trust activities, and (iv) notifying customers that it accepts orders for investment company securities in solicitations related to other activities concerning tax-deferred accounts;	(d) the bank does not effect securities transactions in reliance on this exemption for a trustee or fiduciary account; (e) the bank does not effect securities transactions in reliance on this exemption for an account for a plan described in RULE 242.770(a)(1); and (f) the bank does not effect securities transactions in reliance on the exemption for small banks in RULE 242.761;

PROVIDED THAT THE BANK DOES NOT ACT IN U.S. AS A "CARRYING BROKER" FOR ANY BD IN CONNECTION WITH SUCH ACTIVITIES (OTHER THAN WITH RESPECT TO GOVERNMENT SECURITIES)✷	(4) the bank complies with § 3(a)(4)(C);✷ and (5) the bank makes available to the account securities of investment companies that are not affiliated persons and that are similar to securities made available of investment companies that are affiliated persons. An account is "tax-deferred" under §§ 401(a), 403, 408, 408A or 457 of the Internal Revenue Code. The exception is intended for accommodation transactions. For example, the bank must charge the same custody fee to a customer who engages in many transactions over a period of time as it charges to a customer who engages in none.	(g) the bank complies with § 3(a)(4)(C) (see above ✷); and (h) if the bank accepts an order to effect a transaction in securities of a registered investment company for compensation as described in paragraph (a) above, the bank makes available on the same terms any class of securities of such investment company that the bank can obtain for purchase or sale by bank customers.
	A *carrying broker* carries customer or BD accounts and receives or holds funds or securities for those persons (Rule 15c3-1(a)(2)). A bank acting as a "carrying broker" "facilitates the transfer of funds and securities associated with the clearance and settlement of securities and related margin lending" on behalf of a BD. It also may execute trades for itself and for its customers. A carrying broker relationship is distinguished from a custody relationship by the selection of the bank by the BD rather than by the customer.	
		ACCOUNT FOR WHICH THE BANK ACTS AS CUSTODIAN—RULE 242.762(a). The term means an account subject to a written agreement governing (at least fees, rights and obligations of the bank regarding (1) custody services (safekeeping of securities, settling trades, investing cash balances, collecting income, processing corporate actions, pricing securities positions, and recordkeeping and reporting), and (2) an IRA for which it acts as custodian.
	RULE 3a4-4. A "small bank" may effect transactions in mutual fund shares in a customer's tax-deferred custody account if— (1) the bank is not associated with a BD and has no arrangement with a BD to effect securities transactions for the bank's customers; (2) the bank makes available to the account securities of investment companies that are not affiliated persons and that are similar to securities made available of investment companies that are affiliated persons.	**SMALL BANK CUSTODIAN EXEMPTION—RULE 242.761.** A small bank is exempt from the definition of "broker" to the extent that it effects securities transactions for an account for which the bank acts as custodian if— (a) the bank is not a person associated with a BD;
	(3) the bank does not solicit securities transactions except by (i) delivering advertising and sales literature prepared by an investment company's principal underwriter or by an investment company that is not an affiliated person, (ii) responding to inquiries from potential purchasers (where response is limited to information in prospectus or sales literature prepared by the principal underwriter), (iii) advertising the bank's trust activities, and (iv) notifying its customers that it accepts orders for investment company securities in solicitations related to other activities concerning tax-deferred accounts;	(b) the bank does not publicly solicit such securities transactions except by advertising its trust services; (c) the annual sales compensation received by the bank for effecting such securities transactions does not exceed $100,000 (adjusted for inflation); (d) the bank does not effect securities transactions in reliance on this exemption for a trust or fiduciary account unless it does *not* rely on any exemption under RULES 242.720, 242.721 or 242.722 in the following year;

	(4) any bank employee effecting such transactions (i) is not an associated person of a BD, (ii) has primary duties for the bank other than effecting securities transactions for customers, and (iii) does not receive (from the bank or any other person) compensation for such transactions that varies with (*a*) the size, value or completion of a transaction, (*b*) the amount of securities-related assets gathered, or (*c*) the size or value of any customer's securities account; (5) the bank complies with § 3(a)(4)(C).✸	(e) the bank does not pay its employees any incentive compensation for any transaction effected under this exemption except pursuant to a networking arrangement under the networking exception; and (f) the bank complies with § 3(a)(4)(C) (see above ✸).
	A *small bank* has under $100 million in assets at year-end for the prior two years and is not affiliated with a bank holding company with $1 billion in consolidated assets during the prior two years.	**SMALL BANK—RULE 242.762(h).** The term means a bank that (a) had less than $500 million in assets at year-end for both prior years, and (b) since year-end of the third prior year has not been affiliated with a bank holding company or a savings and loan holding company with consolidated assets of more than $1 billion as of year-end of both prior years.
(ix) EXCEPTION FOR TRANSACTIONS IN *IDENTIFIED BANKING PRODUCTS.* DEPOSIT ACCOUNTS, BANKER'S ACCEPTANCES, BANK LETTERS OF CREDIT AND LOANS, DEBIT ACCOUNTS ARISING FROM CREDIT CARDS, PARTICIPATIONS IN LOANS HELD BY THE BANK OR AN AFFILIATE AND SOLD TO ***QUALIFIED INVESTORS***, AND SWAPS, INCLUDING EQUITY SWAPS SOLD TO ***QUALIFIED INVESTORS.***	NO RULES.	
(x) MUNICIPAL SECURITIES TRANSACTIONS EXCEPTION.	NO RULES.	
(xi) DE MINIMIS EXCEPTION. TRANSACTIONS IN SECURITIES OTHER THAN AS DESCRIBED IN (i)-(x) ABOVE—UP TO 500 TRANSACTIONS PER CALENDAR YEAR	NO RULES.	
OTHER EXEMPTIONS.		**EXEMPTION FOR MONEY MARKET FUND TRANSACTIONS—RULE 242.776(a).** A bank is exempt from the definition of "broker" to the extent that it effects transactions in money market fund securities on behalf of a customer, if— (1)(i) the customer has obtained a financial product or service from the bank not involving securities and is (*a*) a qualified investor or (*b*) a person that directs the purchase of securities from cash flows of an asset-backed security with a minimum original asset amount of $25 million, (ii) the bank effects the transactions in a trustee or fiduciary capacity, or (iii) the bank effects the transactions as escrow agent, collateral agent, depository agent or paying agent; and

		(2)(i) the class of securities is no-load, or (ii) (A) if the class of securities is not no-load, the bank does not characterize it as no-load, and (B) if the customer is not a person described in (1)(i), the bank provides to the customer (no later than the time the customer authorizes the bank to effect the transactions) a prospectus for the securities and a clear and conspicuous notice that (*1*) discloses any payments the bank receives in connection with the transactions from the fund complex of the issuer, (*2*) separately identifies payments that are sales loads, deferred sales loads or 12b-1 plan fees, and (*3*) indicates that the customer should review the prospectus carefully for additional information regarding expenses.
		EXEMPTION FOR TRANSACTIONS IN CERTAIN PLANS—RULE 242.770(a). A bank is exempt from the definition of "broker" to the extent that it effects transactions in securities of an open-end investment company in an account for a qualified plan under section 401(a) of the Internal Revenue Code or a plan described in sections 403(b) or 457 of the Internal Revenue Code for which the bank acts as trustee or custodian, or offers participants a participant-directed brokerage account through a registered BD, if the bank— (1) credits compensation it receives from a fund complex related to securities in which plan assets are invested against fees and expenses that the plan owes to the bank;
		(2) provides a clear and conspicuous disclosure to the plan sponsor or its designated fiduciary that includes all fees and expenses for services to the plan and all compensation received or to be received from a fund complex in a manner that permits the plan sponsor or fiduciary to determine that the bank has credited compensation received from a fund complex related to securities in which plan assets are invested or to be invested against fees and expenses that the plan owes to the bank; (3) does not pay any incentive compensation to an individual not qualified under NASD rules that varies based on the value of a security or the type of security purchased or sold in an account; and (4) complies with § 3(a)(4)(C).✸
		FUND COMPLEX—RULE 242.770(b)(1). The term means the issuer of the security (including the sponsor, depositor or trustee), the issuer of any other security that holds itself out as a related company, any agent or investment adviser of such issuer, and any affiliated person of such issuer or adviser. **PARTICIPANT-DIRECTED BROKERAGE ACCOUNT—RULE 242.770(b)(3).** The term means an account carried by a BD on a fully disclosed basis.

		EXEMPTION FOR TRANSACTIONS PURSUANT TO REGULATION S—RULE 242.771(A). A bank is exempt from the definition of "broker" to the extent that, as agent or as a riskless principal, the bank— (a) effects a sale of an eligible security to a purchase outside the U.S. in compliance with Regulation S; (b) effects a resale of an eligible security after its initial sale in compliance with Regulation S by or on behalf of a person who is not a U.S. person under Regulation S § 902(k) to a purchaser or a registered BD, or such a resale by or on behalf of a registered BD to a purchaser, provided that, if the sale is made prior to the expiration of the distribution compliance period, the sale is in compliance with Regulation S
		ELIGIBLE SECURITY—RULE 242.771(b)(2). The term means a security that (i) is not being sold from the inventory of the bank or an affiliate, and (ii) is not being underwritten by the bank or an affiliate on a firm commitment basis, unless the bank acquired the security from an unaffiliated distributor that did not purchase it from the bank or an affiliate. **PURCHASER—RULE 242.771(b)(3).** The term means a person who purchases an eligible security and who is not a U.S. person under Regulation S § 902(k). **RISKLESS PRINCIPAL TRANSACTION—RULE 242.771(b)(4).** The term means a transaction in which the bank, after receiving a buy (or sell) order from a customer, purchases (sells) the security to offset the contemporaneous sale to (purchase from) the customer.

DEFINITIONS FOR BANK EXCEPTIONS FROM BROKER AND DEALER DEFINITIONS

§ 206 OF GRAMM-LEACH-BLILEY ACT (NOT ASSIGNED TO U.S. CODE). DEFINITION OF "IDENTIFIED BANKING PRODUCTS"—deposit accounts (including savings accounts and certificates of deposit); bankers' acceptances; letters of credit and loans made by banks; credit card accounts; loan participations funded, owned or participated in by the bank, sold to *qualified investors* (defined in § 3(a)(54)) or other persons who have the opportunity to review material information and, based on financial sophistication, net worth and experience in financial matters, the capability to evaluate the information; and *swap agreements* (as defined in § 206 of Gramm-Leach-Bliley Act), including credit swaps and equity swaps sold to *qualified investors*).

§ 206 OF GRAMM-LEACH-BLILEY ACT (NOT ASSIGNED TO U.S. CODE). DEFINITION OF "SWAP AGREEMENT"—individually negotiated contract based in whole or part on the value of, or any event relating to, one or more commodities, securities, currencies, interest rates or other rates, indices or other assets, *not including* any other identified banking product (defined above).

§ 3(a)(54). DEFINITION OF "QUALIFIED INVESTOR"—

- registered investment company or issuer excluded from definition of "investment company" under 1940 Act § 3(c)(7)
- bank, foreign bank, savings association, broker-dealer, associated person of a broker-dealer (other than a natural person), insurance company, business development company or licensed small business investment company
- state employee benefit plan or other employee benefit plan under ERISA, other than an IRA, if investment decisions are made by plan fiduciary that is a bank, savings association, insurance company or registered investment adviser
- trust managed by any of above persons
- market maker (market intermediary exempt under 1940 Act § 3(c)(2))
- foreign government
- company that owns and invests on a discretionary basis at least $25 million, natural person who owns and invests on a discretionary basis at least $25 million
- government or political subdivision, agency or instrumentality that owns and invests on a discretionary basis at least $50 million
- multinational or supranational entity or agency or instrumentality thereof.

§ 902(K) OF REGULATION S. DEFINITION OF "U.S. PERSON"—

- natural person resident in the United States, partnership or corporation organized under U.S. laws
- estate of which any executor or administrator is a U.S. person, trust of which any trustee is a U.S. person
- agency or branch of a foreign entity located in the United States
- non-discretionary or similar account held by a dealer or other fiduciary for a U.S. person
- discretionary or similar account held by a dealer or other fiduciary organized or resident in the United States
- partnership or corporation organized under foreign law and formed by a U.S. person principally for the purpose of investing in unregistered securities unless organized and owned by accredited investors who are not natural persons, estates or trusts.

The following are *not* U.S. persons—

- discretionary or similar account held by a dealer or other fiduciary organized or resident in the United States for a non-U.S. person
- estate of which any professional fiduciary acting as executor or administrator is a U.S. person if an executor or administrator who is not a U.S. person has sole or shared investment discretion over the assets of the estate, and the estate is governed by foreign law
- trust of which any professional fiduciary acting as trustee is a U.S. person if a trustee who is not a U.S. person has sole or shared investment discretion over the assets of the trust and no beneficiary of the trust (and no settler if the trust is revocable) is a U.S. person
- an employee benefit plan established and administered under the laws of a foreign country and under customary practices and documentation of that country
- agency or branch of a U.S. person located outside the United States if the agency or branch operates for valid business reasons, and the agency or branch is engaged in an insurance or banking business and is subject to substantive insurance or banking regulation in the jurisdiction where it is located
- the IMF, International Bank for Reconstruction and Development, Inter-American Development Bank, Asian Development Bank, African Development Bank, United Nations, and similar international organizations, and their agencies, affiliates and pension plans.