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New SEC Rules Implementing Gramm-Leach-Bliley Provisions May Affect 401(k) Industry Business Practices

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As you may know, the Gramm-Leach-Bliley Act, enacted November 12, 1999, replaced a "blanket" exception from the broker registration requirements enjoyed by banks under the Securities Exchange Act of 1934 with a series of limited "functional" exceptions. Although it had been generally believed that Congress intended that these exceptions would allow banks to continue their employee benefit plan business as usual, on May 11, 2001, the SEC issued a complex set of interim final rules that impose strict limits on bank securities activities under the trust and fiduciary activities exception and the exception for custodial activities. See Exchange Act Rel. No. 44291 (May 11, 2001), reprinted at 66 Fed. Reg. 27760 (May 18, 2001).

The interim final rules have provoked strongly-worded comments from banking regulators, however. A June 29, 2001 letter to the SEC from Federal Reserve Board Chairman Alan Greenspan, Comptroller of the Currency John D. Hawke, Jr., and Federal Deposit Insurance Corporation Chairman Donna Tanoue declares that: "we have very serious concerns about the validity and content of a number of provisions of the Interim Final Rules, as well as the process the Commission employed to issue them." The letter also calls the SEC rules "unworkable," "premised on misunderstandings of how certain activities are conducted by banks," and "contrary . . . to congressional intent" and urges the SEC to delay implementation and treat the interim "final" rules as proposed rules. In particular, the letter charges that the SEC's definition of permissible "relationship compensation" excludes "legitimate, long-recognized forms of fiduciary compensation" and challenges the SEC's position that "order-taking" is not activity that banks can perform under the exception custody and safekeeping activities.

"Although banks should continue to review their securities related activities for possible compliance issues, it is very possible that the SEC will, at least, delay the effective date of its interim final rules and significant changes to the interim final rules may be possible."

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The SEC narrowly interpreted the exception for custodial activities by determining that this exception generally does not cover a bank that accepts orders from customers to purchase or sell securities. Under the trust or fiduciary exception (and banks serving as plan or IRA trustees generally will seek to qualify for this exception) a bank must be "chiefly compensated" from "relationship" compensation instead of from "sales" compensation. For this purpose, "sales" compensation is defined broadly to include 12b-1 fees and shareholder service fees paid by mutual funds, while "relationship" compensation is narrowly defined. The SEC has solicited comments on whether "chiefly compensated" should require that 51% or some much higher percentage of a bank's compensation should be restricted to "relationship" compensation.

In order to provide banks time to come into compliance with the interim final rules, the SEC has allowed banks to remain altogether exempt from broker registration until October 1, 2001. Compliance with sales compensation limits will be required as of January 1, 2002.