Private Banking
and Investment Group

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June 25, 2004

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Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street
Washington, DC 20549-0609

Re: Certain Thrift Institutions Deemed Not to be Investment Advisers; File Number S7-20-04

Dear Mr. Katz:

Merrill Lynch Trust Company, FSB ("Merrill Lynch Trust Company") appreciates the opportunity to comment on rule 202(a)(11)-2 proposed by the Securities and Exchange Commission ("Commission") in its April 28, 2004 release (the "Release"). Under the proposed rule, a thrift institution that limits its investment advisory business to acting solely as trustee, executor, administrator or guardian for trusts, estates, guardianships and other accounts created and maintained for a fiduciary purpose[1] would not be deemed to be an investment adviser under the Investment Advisers Act of 1940 (the "Act"), provided that it does not hold itself out to the public as providing investment advisory services. If the thrift chooses to act in other advisory capacities, it would have to maintain its investment advisor registration and would be required to make all of its trust department records available to Commission examiners upon request, although the Act would not apply to accounts that fall within the exception.

Merrill Lynch Trust Company is a federal savings bank chartered and supervised by the Office of Thrift Supervision ("OTS") and is an FDIC-insured institution. It provides personal trust, employee benefit trust and custodial services to clients throughout the United States. In connection with its personal trust services, Merrill Lynch Trust Company may act as trustee, executor, administrator and guardian as well as agent for trustees, executors, administrators and guardians. It may also provide investment advisory services to individuals, charitable entities and other entities established for estate planning purposes. As a thrift institution, Merrill Lynch Trust Company is not

[1] As described by the Commission, "'fiduciary purpose accounts' would include those established in connection with estate planning, conservatorships and guardianships, and those established for minors under the Uniform Gifts to Minors Act," but would not include those "established primarily for money management, custodial or administrative purposes."

considered to be a "bank" under the Act and accordingly is registered with the Commission as an investment adviser.

The omission of thrifts from the exception granted to banks under the Act was not deliberate. As noted in the Release, thrifts were not included in the exception in 1940 because at the time they did not provide services covered by the Act.[2] This background is important because it demonstrates that there was never any specific legislative intent to exclude the fiduciary activities of banks and include the parallel activities of thrifts. Rather, the current disparity is an accident of timing, unintended, unreasonable and unfair.

We commend the Commission for attempting to provide regulatory relief to thrifts that exercise fiduciary powers. We are pleased the Commission recognizes that the Act "cannot be meaningfully applied" to certain fiduciary activities of thrifts and that "these activities are subject to an alternative system of regulation." However, we do not believe the proposed rule goes far enough to relieve thrifts from the burden of dual regulation. We believe that in failing to include a thrift's other fiduciary activities in the exception, the Commission does not accord appropriate weight to that alternative system of regulation. As the Commission notes in the Release, "thrift trust powers and activities have converged with those of banks." Thrifts may be granted the same trust powers as national banks and are subject to virtually the same regulations. Indeed, the Commission recognized in its May 11, 2001 release of interim final rules exempting thrifts from the definition of "broker" and "dealer" (the "2001 Release") that "insured savings associations are subject to a similar regulatory structure and examination standards as banks," and that "it seems reasonable to afford savings associations and savings banks the same type of exemptions." In the 2001 Release, the Commission found that "extending the exemption for banks to savings associations and savings banks is necessary or appropriate in the public interest and is consistent with the protection of investors." Moreover, in the interim final rules and in proposed Regulation B published on June 17, 2004, the trust and fiduciary activities exemption for thrifts is not a partial one, but is co-extensive with that for banks.

The Commission asserts that since there are no "push out" provisions in the Advisers Act comparable to those for brokerage activities in the amendments to the Securities Exchange Act of 1934, a general exception for thrifts under the Advisers Act would exempt a thrift's so-called "retail advisory activities." However, the Commission fails to take into account that such activities are fiduciary activities under OTS regulations[3] and must be conducted within a thrift's trust department in accordance with those regulations and applicable state law. These activities are subject to scrutiny and regular examination

[2] Thrifts were not given the ability to exercise fiduciary powers until passage of the *Depository Institutions Deregulation and Monetary Control Act of 1980.*

[3] A thrift acting as investment adviser for a fee or in any capacity in which it has investment discretion on behalf of another is acting in a fiduciary capacity under 12 C.F.R. §550.30.

by experienced trust examiners in accordance with comprehensive and detailed examination guidelines that address all aspects of asset management, as set forth in the OTS Trust and Asset Management Handbook ("Asset Management Handbook").[4]

The Commission is concerned that a general exception for thrifts would create regulatory disparity and give thrifts an unfair competitive advantage over other money managers and financial planners ("retail advisers"). Today, however, it is thrifts that are subject to regulatory disparity and face an unfair competitive disadvantage as compared to both retail advisers and other bank trust departments. Retail advisers are regulated and examined only by the Commission and not by bank regulators. Bank trust departments are regulated and examined only by bank regulators and not generally by the Commission.[5] By contrast, a thrift's fiduciary activities are regulated and examined by both the OTS and the Commission. Although the proposed rule creates a small measure of parity for thrifts with other banks, it does not significantly relieve thrifts from the burden of dual regulation – a burden that is not shared by either retail advisers or banks. Under the rule as proposed, thrifts would be faced with the Hobson's choice of divesting themselves of accounts the Commission considers to be non-fiduciary (*i.e.,* advisory and managed agency accounts, revocable trusts, trusteed IRAs, and the like) or continuing to be subject to the significant costs and burdens associated with investment adviser registration. At best, that choice perpetuates the disparity; at worst, it places thrifts at a severe competitive disadvantage.

Another concern expressed by the Commission is the elimination of investor protection that might result from granting thrifts a general exception from the Act. We respectfully submit that the combination of federal banking regulation and applicable state law is more than adequate to protect clients of thrift trust departments, be they grantors, beneficiaries, or principals of an agency account. OTS has issued comprehensive regulations and directives in a number of areas that affect fiduciary accounts (which, as noted above, include investment advisory and managed agency accounts). These regulations and directives cover the operation and administration of fiduciary accounts, recordkeeping and confirmation requirements for securities transactions, advertising, and, as the Commission notes in the Release, conflicts of interest. Additionally, state statutes and common law pertaining to trusts and agency relationships impose a number of significant duties on both trustees and agents, including duties of loyalty and prudence. They also require full and fair disclosure of all facts relevant to transactions engaged in by trustees and agents for the benefit of their grantors, beneficiaries and principals.

Thrifts that engage in fiduciary activities are not only subject to a comprehensive body of law and regulations governing those activities, they are also subject to regular and comprehensive examinations on a twelve to eighteen month cycle. In addition to

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[4] The Asset Management Handbook can be found on the OTS web site at http://www.ots.treas.gov.

[5] To the extent that a bank acts as investment adviser to a registered investment company, the bank or its separately identifiable department or division, is subject to the Act and regulation by the Commission.

examinations covering safety and soundness (e.g., capital adequacy, asset quality, management, earnings, liquidity and sensitivity to risk) , information technology systems, and compliance with consumer protection regulations (including those governing privacy, and advertising), thrifts undergo a thorough examination of their fiduciary activities, including their asset management activities, by experienced and well-trained OTS examiners dedicated to trust examination. As described in the Asset Management Handbook, the examination covers, among other things, a thrift's portfolio management activities, administration of marketable securities, selection and monitoring of mutual funds and handling of conflicts of interest.[6] Written Reports of Examination addressing any or all of the above areas are presented by the OTS to a thrift's senior management and Board of Directors to apprise them of any recommended or required corrective actions.

For the above reasons, we urge the Commission to provide thrifts with an exemption under the Act that is co-extensive with the exemption provided to banks and trust companies. If the Commission nonetheless determines to provide a limited exception for thrifts, we respectfully suggest the following modifications:

- The Commission should expand the scope of the exception to include thrifts when they act as agent for accounts that have a fiduciary purpose. Thrift trust departments, like those of other banks and trust companies, are in a unique position to assist individual fiduciaries by providing not only investment advice, but other kinds of advice and services that retail advisers do not generally have the ability or expertise to provide. For example, corporate fiduciaries acting as agent for other fiduciaries may provide principal and income accounting, prepare fiduciary tax returns, assist with tax planning and post mortem planning, calculate and implement trust divisions, perform annual and charitable trust valuations, assist in balancing the needs of current and remainder beneficiaries, prepare filings with state Attorneys General, compute required annual distributions, help fiduciaries avoid adverse tax consequences (such as those resulting from unrelated business taxable income in charitable trusts) provide fiduciaries with advice and guidance regarding discretionary distributions and assist fiduciaries in meeting other such fiduciary responsibilities.

- The Commission should consider *all* revocable trusts to be established for a fiduciary purpose. In our experience, the vast majority of revocable trusts are established for estate planning purposes, often as will substitutes in states with high probate costs. Some are established to provide for grantors in the event of their future incapacity. Where money management is the only object, clients are averse to incurring the costs of trust document preparation when an investment management agreement will suffice. By categorizing some revocable trusts as not being established for a fiduciary purpose, the Commission would force thrifts to undergo a prohibitively costly, challenging and time-consuming analysis of its trust accounts to identify those

[6] See Asset Management Handbook, Section 800 *et seq.*

revocable trusts that might not pass muster under the Commission's "fiduciary purpose" test. Ultimately, such an analysis would be quite subjective in that a thrift would need to determine the underlying "intent" of clients who establish revocable trusts.

- The Commission should expand the exception to include other accounts, whether trust or agency, where the account has a fiduciary purpose. For example, IRA trusts today are often established for estate planning purposes. Many Americans have accumulated substantial wealth in their retirement plans. Retirement assets frequently comprise a substantial part of an individual's estate. Through the use of customized trusts or beneficiary designations, IRAs today may continue in trust after the IRA owner's death. These accounts should be distinguished from IRAs that do not have an estate planning component and do not require the expertise of a corporate fiduciary.

- The Commission should eliminate the requirement that thrifts choosing to act in advisory capacities not excepted under the rule must make available to Commission examiners all of their trust department records rather than only the records that pertain to the covered accounts. This requirement diminishes the relief provided by the rule and creates further disparity for thrifts that choose to retain such business. The Commission appears concerned that without access to these records, it will not be able to determine whether a thrift institution has fairly allocated initial public offerings and other trades between "advisory clients" and other trust department clients. However, to a thrift, all of these clients are fiduciary clients. Evaluation of its policies, procedures and internal controls regarding trade allocations and initial public offerings is part of the OTS's Portfolio Management Examination Program[7] and should be sufficient to protect the interests of investors.

In conclusion, we believe the Commission should grant thrifts an exemption from the Act that is co-extensive with that provided to other banks and trust companies with which thrifts compete. Thrifts are subject to the same comprehensive banking regulations and examinations as other banks, and that level of regulation is more than adequate for the protection of investors. Because they are subject to dual regulation, thrifts are at a competitive disadvantage not only with banks but with retail advisers as well. We urge the Commission to provide thrifts full parity with other banks. Absent that, we urge the Commission to extend the exemption to thrifts acting as agent for accounts having a fiduciary purpose, include all revocable trusts in the category of accounts having a fiduciary purpose, expand the exception to include other accounts that can be demonstrated to have a fiduciary purpose, and eliminate the requirement that all thrifts that maintain accounts requiring them to be registered under the Act must make available for examination *all* trust department records and not just those pertaining to the covered accounts. Thus, because thrifts acting in fiduciary capacities generally do not compete

[7] See Asset Management Handbook, Section 810.

with retail advisers and are subject to comprehensive banking regulation and supervision, granting thrifts an exemption that is co-extensive with that granted to other banks will not prejudice retail advisers or harm investors.

Once again, we thank the SEC for the opportunity to provide the above comments.

Very truly yours,

Christian G. Heilmann
Chairman and CEO
Merrill Lynch Trust Company, FSB