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the calendar year ending December 31, 2006; and

(ii) Multiplying the dollar amount by the quotient obtained in paragraph (f)(1)(i) of this section.

(2) *Rounding.* If the adjusted dollar amount determined under paragraph (f)(1) of this section for any period is not a multiple of \$1, the amount so determined shall be rounded to the nearest multiple of \$1.

§218.701 Exemption from the definition of “broker” for certain institutional referrals.

(a) *General.* A bank that meets the requirements for the exception from the definition of “broker” under section 3(a)(4)(B)(i) of the Act (15 U.S.C. 78c(a)(4)(B)(i)), other than section 3(a)(4)(B)(i)(VI) of the Act (15 U.S.C. 78c(a)(4)(B)(i)(VI)), is exempt from the conditions of section 3(a)(4)(B)(i)(VI) of the Act solely to the extent that a bank employee receives a referral fee for referring a high net worth customer or institutional customer to a broker or dealer with which the bank has a contractual or other written arrangement of the type specified in section 3(a)(4)(B)(i) of the Act, if:

(1) *Bank employee.* (i) The bank employee is:

(A) Not registered or approved, or otherwise required to be registered or approved, in accordance with the qualification standards established by the rules of any self-regulatory organization;

(B) Predominantly engaged in banking activities other than making referrals to a broker or dealer; and

(C) Not subject to statutory disqualification, as that term is defined in section 3(a)(39) of the Act (15 U.S.C. 78c(a)(39)), except subparagraph (E) of that section; and

(ii) The high net worth customer or institutional customer is encountered by the bank employee in the ordinary course of the employee’s assigned duties for the bank.

(2) *Bank determinations and obligations—(i) Disclosures.* The bank provides the high net worth customer or institutional customer the information set forth in paragraph (b) of this section

(A) In writing prior to or at the time of the referral; or

(B) Orally prior to or at the time of the referral and

(1) The bank provides such information to the customer in writing within 3 business days of the date on which the bank employee refers the customer to the broker or dealer; or

(2) The written agreement between the bank and the broker or dealer provides for the broker or dealer to provide such information to the customer in writing in accordance with paragraph (a)(3)(i) of this section.

(i) *Customer qualification.* (A) In the case of a customer that is a not a natural person, the bank has a reasonable basis to believe that the customer is an institutional customer before the referral fee is paid to the bank employee.

(B) In the case of a customer that is a natural person, the bank has a reasonable basis to believe that the customer is a high net worth customer prior to or at the time of the referral.

(iii) *Employee qualification information.* Before a referral fee is paid to a bank employee under this section, the bank provides the broker or dealer the name of the employee and such other identifying information that may be necessary for the broker or dealer to determine whether the bank employee is registered or approved, or otherwise required to be registered or approved, in accordance with the qualification standards established by the rules of any self-regulatory organization or is subject to statutory disqualification, as that term is defined in section 3(a)(39) of the Act (15 U.S.C. 78c(a)(39)), except subparagraph (E) of that section.

(iv) *Good faith compliance and corrections.* A bank that acts in good faith and that has reasonable policies and procedures in place to comply with the requirements of this section shall not be considered a “broker” under section 3(a)(4) of the Act (15 U.S.C. 78c(a)(4)) solely because the bank fails to comply with the provisions of this paragraph (a)(2) with respect to a particular customer if the bank:

(A) Takes reasonable and prompt steps to remedy the error (such as, for example, by promptly making the required determination or promptly providing the broker or dealer the required information); and

(B) Makes reasonable efforts to reclaim the portion of the referral fee paid to the bank employee for the referral that does not, following any required remedial action, meet the requirements of this section and that exceeds the amount otherwise permitted under section 3(a)(4)(B)(i)(VI) of the Act (15 U.S.C. 78c(a)(4)(B)(i)(VI)) and §218.700.

(3) *Provisions of written agreement.* The written agreement between the bank and the broker or dealer shall require that:

(i) *Broker-dealer written disclosures.* If, pursuant to paragraph (a)(2)(i)(B)(2) of this section, the broker or dealer is to provide the customer in writing the disclosures set forth in paragraph (b) of this section, the broker or dealer provides such information to the customer in writing:

(A) Prior to or at the time the customer begins the process of opening an account at the broker or dealer, if the customer does not have an account with the broker or dealer; or

(B) Prior to the time the customer places an order for a securities transaction with the broker or dealer as a result of the referral, if the customer already has an account at the broker or dealer.

(ii) *Customer and employee qualifications.* Before the referral fee is paid to the bank employee:

(A) The broker or dealer determine that the bank employee is not subject to statutory disqualification, as that term is defined in section 3(a)(39) of the Act (15 U.S.C. 78c(a)(39)), except subparagraph (E) of that section; and

(B) The broker or dealer has a reasonable basis to believe that the customer is a high net worth customer or an institutional customer.

(iii) *Suitability or sophistication determination by broker or dealer—(A) Contingent referral fees.* In any case in which payment of the referral fee is contingent on completion of a securities transaction at the broker or dealer, the broker or dealer, before such securities transaction is conducted, perform a suitability analysis of the securities transaction in accordance with the rules of the broker or dealer's applicable self-regulatory organization as if

the broker or dealer had recommended the securities transaction.

(B) *Non-contingent referral fees.* In any case in which payment of the referral fee is not contingent on the completion of a securities transaction at the broker or dealer, the broker or dealer, before the referral fee is paid, either:

(1) Determine that the customer:

(i) Has the capability to evaluate investment risk and make independent decisions; and

(ii) Is exercising independent judgment based on the customer's own independent assessment of the opportunities and risks presented by a potential investment, market factors and other investment considerations; or

(2) Perform a suitability analysis of all securities transactions requested by the customer contemporaneously with the referral in accordance with the rules of the broker or dealer's applicable self-regulatory organization as if the broker or dealer had recommended the securities transaction.

(iv) *Notice to the customer.* The broker or dealer inform the customer if the broker or dealer determines that the customer or the securities transaction(s) to be conducted by the customer does not meet the applicable standard set forth in paragraph (a)(3)(iii) of this section.

(v) *Notice to the bank.* The broker or dealer promptly inform the bank if the broker or dealer determines that:

(A) The customer is not a high net worth customer or institutional customer, as applicable; or

(B) The bank employee is subject to statutory disqualification, as that term is defined in section 3(a)(39) of the Act (15 U.S.C. 78c(a)(39)), except subparagraph (E) of that section.

(b) *Required disclosures.* The disclosures provided to the high net worth customer or institutional customer pursuant to paragraphs (a)(2)(i) or (a)(3)(i) of this section shall clearly and conspicuously disclose

(1) The name of the broker or dealer; and

(2) That the bank employee participates in an incentive compensation program under which the bank employee may receive a fee of more than a nominal amount for referring the customer to the broker or dealer and

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payment of this fee may be contingent on whether the referral results in a transaction with the broker or dealer.

(c) *Receipt of other compensation.* Nothing in this section prevents or prohibits a bank from paying or a bank employee from receiving any type of compensation that would not be considered incentive compensation under §218.700(b)(1) or that is described in §218.700(b)(2).

(d) *Definitions.* When used in this section:

(1) *High net worth customer*—(i) *General.* *High net worth customer* means:

(A) Any natural person who, either individually or jointly with his or her spouse, has at least \$5 million in net worth excluding the primary residence and associated liabilities of the person and, if applicable, his or her spouse; and

(B) Any revocable, inter vivos or living trust the settlor of which is a natural person who, either individually or jointly with his or her spouse, meets the net worth standard set forth in paragraph (d)(1)(i)(A) of this section.

(ii) *Individual and spousal assets.* In determining whether any person is a high net worth customer, there may be included in the assets of such person

(A) Any assets held individually;

(B) If the person is acting jointly with his or her spouse, any assets of the person's spouse (whether or not such assets are held jointly); and

(C) If the person is not acting jointly with his or her spouse, fifty percent of any assets held jointly with such person's spouse and any assets in which such person shares with such person's spouse a community property or similar shared ownership interest.

(2) *Institutional customer* means any corporation, partnership, limited liability company, trust or other non-natural person that has, or is controlled by a non-natural person that has, at least:

(i) \$10 million in investments; or

(ii) \$20 million in revenues; or

(iii) \$15 million in revenues if the bank employee refers the customer to the broker or dealer for investment banking services.

(3) *Investment banking services* includes, without limitation, acting as an underwriter in an offering for an

issuer; acting as a financial adviser in a merger, acquisition, tender offer or similar transaction; providing venture capital, equity lines of credit, private investment-private equity transactions or similar investments; serving as placement agent for an issuer; and engaging in similar activities.

(4) *Referral fee* means a fee (paid in one or more installments) for the referral of a customer to a broker or dealer that is:

(i) A predetermined dollar amount, or a dollar amount determined in accordance with a predetermined formula (such as a fixed percentage of the dollar amount of total assets placed in an account with the broker or dealer), that does not vary based on:

(A) The revenue generated by or the profitability of securities transactions conducted by the customer with the broker or dealer; or

(B) The quantity, price, or identity of securities transactions conducted over time by the customer with the broker or dealer; or

(C) The number of customer referrals made; or

(ii) A dollar amount based on a fixed percentage of the revenues received by the broker or dealer for investment banking services provided to the customer.

(e) *Inflation adjustments*—(1) *In general.* On April 1, 2012, and on the 1st day of each subsequent 5-year period, each dollar amount in paragraphs (d)(1) and (d)(2) of this section shall be adjusted by:

(i) Dividing the annual value of the Personal Consumption Expenditures Chain-Type Price Index (or any successor index thereto), as published by the Department of Commerce, for the calendar year preceding the calendar year in which the adjustment is being made by the annual value of such index (or successor) for the calendar year ending December 31, 2006; and

(ii) Multiplying the dollar amount by the quotient obtained in paragraph (e)(1)(i) of this section.

(2) *Rounding.* If the adjusted dollar amount determined under paragraph (e)(1) of this section for any period is not a multiple of \$100,000, the amount so determined shall be rounded to the nearest multiple of \$100,000.