

(1) Selecting and negotiating with a borrower and executing, or directing the execution of the loan with the borrower;

(2) Receiving, delivering, or directing the receipt or delivery of loaned securities;

(3) Receiving, delivering, or directing the receipt or delivery of collateral;

(4) Providing mark-to-market, corporate action, recordkeeping or other services incidental to the administration of the securities lending transaction;

(5) Investing, or directing the investment of, cash collateral; or

(6) Indemnifying the lender of securities with respect to various matters.

**§ 240.775 Exemption from the definition of “broker” for the way banks effect excepted or exempted transactions in investment company securities.**

(a) A bank that meets the conditions for an exception or exemption from the definition of the term “broker” except for the condition in section 3(a)(4)(C)(i) of the Act (15 U.S.C. 78c(a)(4)(C)(i)), is exempt from such condition to the extent that it effects transactions in securities issued by an open-end company that is neither traded on a national securities exchange nor through the facilities of a national securities association or an interdealer quotation system, provided that:

(1) Such transactions are effected through the National Securities Clearing Corporation’s Mutual Fund Services or directly with a transfer agent acting for the open-end company; and

(2) The securities are distributed by a registered broker or dealer, or the sales charge is no more than the amount a registered broker or dealer may charge pursuant to the rules of a securities association registered under section 15A of the Act (15 U.S.C. 78o-3) adopted pursuant to section 22(b)(1) of the Investment Company Act of 1940 (15 U.S.C. 80a-22(b)(1)).

(b) *Definitions.* For purposes of this section:

(1) *Interdealer quotation system* has the same meaning as in 17 CFR 240.15c2-11.

(2) *Open-end company* has the same meaning as in § 240.740.

**§ 240.780 Exemption for banks from liability under section 29 of the Securities Exchange Act of 1934.**

(a) No contract entered into before [date 18 months after effective date of the final rule], shall be void or considered voidable by reason of section 29(b) of the Act (15 U.S.C. 78cc(b)) because any bank that is a party to the contract violated the registration requirements of section 15(a) of the Act (15 U.S.C. 78o(a)), any other applicable

provision of the Act, or the rules and regulations thereunder based solely on the bank’s status as a broker when the contract was created.

(b) No contract shall be void or considered voidable by reason of section 29(b) of the Act (15 U.S.C. 78cc(b)) because any bank that is a party to the contract violated the registration requirements of section 15(a) of the Act (15 U.S.C. 78o(a)) or the rules and regulations thereunder based solely on the bank’s status as a broker when the contract was created, if:

(1) At the time the contract was created, the bank acted in good faith and had reasonable policies and procedures in place to comply with section 3(a)(4)(B) of the Act (15 U.S.C. 78c(a)(4)(B)) and the rules and regulations thereunder; and

(2) At the time the contract was created, any violation of the registration requirements of section 15(a) of the Act by the bank did not result in any significant harm or financial loss or cost to the person seeking to void the contract.

**§ 240.781 Exemption from the definition of “broker” for banks for a limited period of time.**

A bank is exempt from the definition of the term “broker” under section 3(a)(4) of the Act (15 U.S.C. 78c(a)(4)) until the first day of its first fiscal year commencing after June 30, 2008.

By order of the Board of Governors of the Federal Reserve System, December 18, 2006.

**Jennifer J. Johnson,**  
*Secretary of the Board.*

Dated: December 18, 2006.

By the Securities and Exchange Commission.

**Nancy M. Morris,**  
*Secretary.*

[FR Doc. 06-9825 Filed 12-22-06; 8:45 am]  
BILLING CODE 6210-01-P; 8011-01-P

**SECURITIES AND EXCHANGE COMMISSION**

**17 CFR Part 240**

[Release No. 34-54947; File No. S7-23-06]

RIN 3235-AJ77

**Exemptions for Banks Under Section 3(a)(5) of the Securities Exchange Act of 1934 and Related Rules**

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Proposed rule.

**SUMMARY:** The Securities and Exchange Commission is publishing for comment proposed rules and rule amendments

regarding exemptions from the definitions of “broker” and “dealer” under the Securities Exchange Act of 1934 (“Exchange Act”) for banks’ securities activities. In particular, the Commission is re-proposing a conditional exemption originally proposed in 2004 that would allow banks to effect riskless principal transactions with non-U.S. persons pursuant to Regulation S under the Securities Act of 1933 (“Securities Act”). The Commission also is proposing to amend and redesignate an existing exemption from the definition of “dealer” for banks’ securities lending activities as a conduit lender. In addition, the Commission is proposing to amend a rule that grants a limited exemption from U.S. broker-dealer registration for foreign broker-dealers, conforming the rule to amended definitions of “broker” and “dealer” under the Exchange Act. Finally, the Commission is requesting comment on its intention to withdraw a rule defining the term “bank” for purposes of Sections 3(a)(4) and 3(a)(5) of the Exchange Act, because of judicial invalidation, a time-limited exemption for banks’ securities activities, because of the passage of time, and an exemption from the definition of “broker” and “dealer” for savings associations and savings banks, an exemption no longer necessary because of the passage of the Regulatory Relief Act.

**DATES:** Comments should be received on or before March 26, 2007.

**ADDRESSES:** Comments may be submitted by any of the following methods:

*Electronic Comments:*

- Use the Commission’s Internet comment form (<http://www.sec.gov/rules/proposed.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number S7-23-06 on the subject line.

*Paper Comments*

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-1090.

All submissions should refer to File Number S7-23-06. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission’s Internet Web site (<http://www.sec.gov/rules/proposed.shtml>). Comments are also

available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

**FOR FURTHER INFORMATION CONTACT:**

Catherine McGuire, Chief Counsel; Linda Stamp Sundberg, Senior Special Counsel, at (202) 551-5550, Office of the Chief Counsel, Division of Market Regulation, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549.

**SUPPLEMENTARY INFORMATION:** The Securities and Exchange Commission is requesting public comment on proposed Rules 3a5-2, 3a5-3, and 15a-6 under the Exchange Act.

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**I. Introduction and Background**

Today, the Commission and the Board of Governors of the Federal Reserve System ("Board") are requesting comment on jointly proposed rules to implement the broker exceptions for banks relating to third-party networking arrangements, trust and fiduciary activities, sweep activities, and safekeeping and custody activities.<sup>1</sup>

The proposals in this release are intended to complement the Joint Proposal.<sup>2</sup> In particular, we re-propose

<sup>1</sup> Exchange Act Release No. 54946 (Dec. 18, 2006) ("Joint Proposal").

<sup>2</sup> On May 11, 2001, the Commission adopted interim final rules ("the Interim Rules") regarding the Gramm-Leach-Bliley Act ("GLBA") definitions of broker and dealer. See Exchange Act Release No. 44291 (May 11, 2001), 66 FR 27760 (May 18, 2001) (<http://www.sec.gov/rules/final/34-44291.htm>). On June 17, 2004, the Commission proposed Regulation B. See Exchange Act Release No. 49879 (June 17,

(and propose to redesignate as Rule 3a5-2) a conditional exemption from the definition of dealer for banks to purchase from and sell to non-U.S. persons offerings in securities exempt under Regulation S.<sup>3</sup> In addition, we propose a clarifying amendment to Exchange Act Rule 15a-6,<sup>4</sup> which provides a conditional exemption from U.S. broker-dealer registration for certain foreign broker-dealers. This amendment would conform the language of Rule 15a-6 to more closely track the statutory changes made by the GLBA. We also propose to redesignate as new Rule 3a5-3 existing Rule 15a-11 and to amend this exemption from the definition of dealer for banks' conduit securities lending activities. Finally, we propose to withdraw Exchange Act Rule 3b-9,<sup>5</sup> in which the Commission defined the term "bank" for purposes of Sections 3(a)(4)<sup>6</sup> and 3(a)(5)<sup>7</sup> of the Exchange Act, due to judicial invalidation, Exchange Act Rule 15a-8,<sup>8</sup> a time-limited exemption for banks' securities activities, because of the passage of time, and Exchange Act Rule 15a-9,<sup>9</sup> an exemption from the definitions of "broker" and "dealer" for savings associations and savings banks, an exemption no longer necessary after passage of the Regulatory Relief Act.

**II. The Proposed Rules and Rule Amendments**

*A. Regulation S Transactions With Non-U.S. Persons*

In response to an industry request,<sup>10</sup> the Commission proposed Exchange Act

2004), 69 FR 39682 (June 30, 2004) (<http://www.sec.gov/rules/proposed/34-49879.htm>). Both the Interim Rules as they apply to the broker activities of banks and Regulation B are superseded by the current joint rulemaking. The Regulatory Relief Act does not directly affect the operation of the rules the Commission adopted concerning banks' dealer activities. See Exchange Act Release No. 47364 (Feb. 13, 2003), 68 FR 8686 (Feb. 24, 2003) (<http://www.sec.gov/rules/final/34-47364.htm>). However, we are proposing some limited amendments to separate and redesignate certain rules that provide exemptions to the definitions of both broker and dealer.

<sup>3</sup> The rule was proposed in 2004 but no further action on the proposed rule was taken by the Commission.

<sup>4</sup> 17 CFR 240.15a-6.

<sup>5</sup> 17 CFR 240.3b-9.

<sup>6</sup> 15 U.S.C. 78c(a)(4).

<sup>7</sup> 15 U.S.C. 78c(a)(5).

<sup>8</sup> 17 CFR 240.15a-8.

<sup>9</sup> 17 CFR 240.15a-9.

<sup>10</sup> See letter dated May 27, 2004, from Lawrence R. Uhlick, Executive Director and General Counsel, Institute of International Bankers to Catherine McGuire, Chief Counsel, Division of Market Regulation, Securities and Exchange Commission (<http://www.sec.gov/rules/proposed/s72604.shtml>). Regulation S [17 CFR 230.901, *et seq.*] specifies the requirements for an offer or sale of securities to be deemed to occur outside the United States and therefore not subject to the registration

Rule 771 in 2004.<sup>11</sup> We are re-proposing at this time the exemption we proposed in 2004, as applied to banks' dealer activities, substantially as proposed. As originally proposed, this rule would provide banks with a conditional exemption from the definition of "dealer" to engage in transactions with non-U.S. persons pursuant to Regulation S under the Securities Act of 1933.<sup>12</sup> In particular, a bank could purchase and sell "eligible securities"<sup>13</sup> to offshore, non-U.S. persons on a "riskless principal" basis.<sup>14</sup> A bank could also resell any eligible Regulation S security, after its purchase and after its initial issuance, to a non-U.S. person as long as the bank continues to comply with the requirements of Regulation S.<sup>15</sup> After the requirements of Regulation S cease to apply to an issuance, a bank could resell such a security to another non-U.S. person or a broker-dealer, as long as the transaction complies with another bank broker or dealer exception or exemption.

In explaining the need for an exemption, the industry group expressed the view to the Commission

requirements of Section 5 of the Securities Act. Regulation S permits the sale of newly issued off-shore securities and re-sales of off-shore securities from a non-U.S. person to a non-U.S. person.

<sup>11</sup> See Exchange Act Release No. 49879, *supra* note 2. The Commission originally proposed this exemption to cover both a banks' broker and dealer securities activities. The Commission and the Board are jointly re-proposing this exemption for banks' broker activities in response to passage of the Financial Services Regulatory Relief Act of 2006, Pub. L. 109-351, 120 Stat. 1966 (2006) ("Regulatory Relief Act"), which requires a joint proposal and provides that the final rules will supersede the existing bank broker rules. See text at note 36 *infra*.

<sup>12</sup> Persons that conduct a broker or dealer business while located in the United States must register as broker-dealers (absent an exemption), even if they direct all of their selling efforts offshore. Exchange Act Release No. 27017 (July 11, 1989), 54 FR 30013, 30016 (July 19, 1989). Nothing in proposed Rule 771 would affect the necessity of complying with Regulation S (17 CFR 230.904) or any other requirements of or exemptions from the Securities Act. Since the original proposal covered both agency and riskless principal transactions, an exemption for agency (brokerage) transactions is being separately proposed as a part of the Joint Proposal.

<sup>13</sup> Proposed Rule 771 would define an "eligible security" as a security not being sold from the inventory of the bank or an affiliate of the bank, and not being underwritten by the bank or an affiliate of the bank on a firm-commitment basis unless the bank acquired the security from an unaffiliated distributor that did not purchase the security from the bank or a bank affiliate.

<sup>14</sup> Proposed Rule 771 would define a "riskless principal transaction" as a transaction in which, after receiving an order to buy from a customer, the bank purchased the security from another person to offset a contemporaneous sale to such customer or, after having received an order to sell from a customer, the bank sold the security to another person to offset a contemporaneous purchase from such customer.

<sup>15</sup> Rule 904 of Regulation S (17 CFR 230.904).

staff that non-U.S. persons expect to deal with one private banker, and that these customers would not choose to deal with a registered broker-dealer to conduct securities transactions in Regulation S securities, but would instead look to foreign banks to effect these transactions.

We are re-proposing this exemption for the same reasons we proposed it in 2004. In proposing this exemption, we noted that the limited conditions in the proposed rule reflected our belief that non-U.S. persons generally will not be relying on the protections of the U.S. securities laws when purchasing Regulation S securities from U.S. banks.<sup>16</sup> By their terms, these securities are not intended to be sold within the U.S. We also expressed our understanding that non-U.S. persons can purchase the same securities from banks located outside of the U.S. We invited comment on whether U.S. broker-dealer registration should be required with respect to transactions with these non-U.S. persons who are purchasing new offering securities offshore, or may be selling or purchasing seasoned securities.

We received few comments on this proposed exemption.<sup>17</sup> Commenters generally supported proposed Rule 771, stating that it would allow banks to compete with foreign banks not subject to Commission regulation.<sup>18</sup> However, several commenters urged the Commission to broaden the proposed exemption. For example, one

<sup>16</sup> Exchange Act Release No. 49879, *supra* note 2, 69 FR 39720. We also explained that although we generally believe that U.S. broker-dealers should be subject to the same standards of conduct when dealing with non-U.S. persons, this principle is less compelling when the foreign person has chosen to deal with a U.S. bank with respect to Regulation S securities that are designed to be sold to non-U.S. persons offshore.

Moreover, while no rules have been adopted, the exemption provided by Exchange Act Section 30(b), concerning foreign securities, has been held unavailable if the United States is used as a base for securities fraud perpetrated on foreigners, *Arthur Lipper Corp. v. SEC*, 547 F.2d 171 (2d Cir. 1976), *reh. denied*, 551 F.2d 915 (2d Cir. 1977), *cert. denied* 434 U.S. 1009.

<sup>17</sup> See, e.g., letter dated September 1, 2004 from Jeffrey P. Neubert, President and CEO, the Clearing House ("Clearing House letter"); letter dated September 1, 2004 from Lawrence R. Uhlick, Executive Director and Chief Counsel, Institute of International Bankers ("IIB letter"); letter dated September 1, 2004 from Agustin Abalo, President, Florida International Bankers Association, Inc. ("FIBA letter"); letter dated September 1, 2004 from Sarah A. Miller, Director, Center for Securities, Trust and Investment, American Bankers Association and General Counsel, ABA Securities Association ("ABA/ABASA letter"); and letter dated September 1, 2004 from Charles C. Cutrell, III, Executive Vice President and General Counsel, State Street Bank and Trust Company ("State Street letter").

<sup>18</sup> See, e.g., Clearing House letter, IIB letter.

commenter suggested that the Commission modify the proposed exemption to include transactions for foreign investors in all securities sold in the United States.<sup>19</sup> Two commenters urged the Commission to amend the proposed definition of "eligible security" to eliminate the restriction on banks' selling securities from the inventory of affiliates or those underwritten by affiliates.<sup>20</sup> Two commenters suggested that the Commission expand the exemption to cover all secondary market trading with offshore persons in any "foreign securities" not effected on a U.S. exchange or Nasdaq, stating that it is burdensome for a bank to determine whether a security was initially sold in compliance with Regulation S.<sup>21</sup> One commenter also stated that to the extent the proposed rule requires a bank to make any determination or conduct any investigation of the way in which a security was initially offered, the rule should only require the bank to have a "reasonable belief" that the eligible security was initially sold in compliance with Regulation S.<sup>22</sup> In this commenter's view, a bank may not have direct access to all of the information necessary to determine whether a security was initially offered under Regulation S or part of a class that was offered under Regulation S.<sup>23</sup>

After carefully considering the comments, we are proposing the exemption for banks' riskless principal transactions in Regulation S securities, as new Rule 3a5-2, substantially as initially proposed. This proposed rule, however, incorporates the reasonable belief standard suggested by one of the commenters because we are persuaded that a bank should not suffer the loss of the exemption when due care is taken to identify the source of a security, even if an error in the identification occurs.<sup>24</sup> We request comment on all aspects of Proposed Rule 3a5-2.

<sup>19</sup> State Street letter.

<sup>20</sup> See Clearing House letter; ABA/ABASA letter.

<sup>21</sup> IIB letter, FIBA letter.

<sup>22</sup> IIB letter.

<sup>23</sup> IIB letter. This commenter noted, however, that a bank may be able to obtain certain information regarding the security from third party information vendors or may need to rely on information statements or offering memoranda, filings, or other third-party sources to determine how the security was offered. This commenter said that the bank's exemption should not be jeopardized if this information is inaccurate or misleading as long as the bank had a reasonable belief that the information upon which it was relying was accurate and complete.

<sup>24</sup> In addition to adding the reasonable belief standard, the re-proposal includes some non-substantive clarifying changes to the text of the rule as proposed in 2004.

### B. Amendment to Exchange Act Rule 15a-6

In 2004, the Commission also proposed a clarifying amendment to Exchange Act Rule 15a-6, which provides a conditional exemption from U.S. broker-dealer registration for certain foreign broker-dealers.<sup>25</sup> Exchange Act Rule 15a-6(a)(4)(i) allows a foreign broker-dealer, without registering in the United States, to effect transactions in securities with or for a U.S.-registered broker-dealer or bank acting "in a broker-dealer capacity as permitted by U.S. law."<sup>26</sup> Thus, in transactions between a U.S. bank and its foreign broker-dealer affiliate, acting as principal, the U.S. bank could rely on the affiliate transactions exception in the GLBA,<sup>27</sup> and the foreign affiliate could rely on Rule 15a-6(a)(4)(i). As the Commission explained in 2001, however, Exchange Act Rule 15a-6(a)(4)(i) does not permit a foreign broker-dealer or bank to have direct contact with customers of the U.S. bank.<sup>28</sup> Moreover, the GLBA affiliate transactions exception from the definition of broker for banks would not permit the U.S. bank to effect transactions with the bank's foreign affiliate's customers.<sup>29</sup> We received no comments on our 2001 discussion of the interplay between Exchange Act Rule 15a-6 and the affiliate transactions exemption and we are taking the same approach in the current proposal.

In light of the amended definitions of "broker" and "dealer," the Commission proposed an amendment to Exchange Act Rule 15a-6 in 2004.<sup>30</sup> Currently, Exchange Act Rule 15a-6(a)(4)(i) refers to "a bank acting in a broker or dealer

<sup>25</sup> Even when the GLBA permits a bank to engage in securities-related activities without itself registering as a broker-dealer, a broker-dealer engaged in the business of effecting transactions for such bank still must register—absent an exemption or other exclusion from the broker-dealer registration requirements of the Exchange Act. For instance, a foreign broker-dealer that executes trades for a bank under Exchange Act Section 3(a)(4)(C) would need to register as a U.S. broker-dealer if it does not meet the conditions of Exchange Act Rule 15a-6, or it does not otherwise qualify for an exemption from registration. Foreign banks cannot rely on the GLBA bank exceptions because they do not meet the definition of "bank" in Exchange Act Section 3(a)(6). However, U.S. branches and agencies of foreign banks would meet the definition of bank. See Exchange Act Release No. 27017, *supra* note 12, 54 FR 30015.

<sup>26</sup> 17 CFR 240.15a-6(a)(4)(i).

<sup>27</sup> 15 U.S.C. 78c(a)(4)(B)(vi).

<sup>28</sup> Exchange Act Release No. 44291, *supra* note 2.

<sup>29</sup> *Id.* If the Commission were to adopt the exemptions for Regulation S securities, proposed *supra*, a bank would be permitted to sell Regulation S securities to non-U.S. persons, including customers of a foreign affiliate, as long as it met the conditions of that exemption.

<sup>30</sup> Release No. 49879, *supra* note 2.

capacity as permitted by U.S. law.” As amended, however, the definitions of ‘broker’ and ‘dealer’ in Exchange Act Section 3(a)(4) and 3(a)(5), respectively, provide that banks engaging in the activities permitted under the conditional exceptions in those definitions “shall not be considered to be” brokers or dealers. To reflect this change, we proposed to amend Exchange Act Rule 15a-6(a)(4)(i) by replacing the phrase “in a broker or dealer capacity as permitted by U.S. law” with the phrase “pursuant to an exception or exemption from the definition of ‘broker’ or ‘dealer’ in Sections 3(a)(4)(B) or 3(a)(5)(C) of the Act.”<sup>31</sup> We are now proposing to conform Rule 15a-6 to the changes made by the GLBA by incorporating the rules applicable to banks’ broker and dealer activities as well as the statutory provisions with the addition of the phrase, “or the rules thereunder.” We are therefore re-proposing this modified clarifying amendment to Rule 15a-6. We request comment on all aspects of this proposal.

### C. Securities Lending by Bank Dealers

In 2003, the Commission adopted Exchange Act Rule 15a-11, which provides a conditional exemption from the definitions of both “broker” and “dealer” for banks engaging in securities lending transactions.<sup>32</sup> Rule 15a-11 provides that a bank is exempt from the definition of “broker” and “dealer” under Sections 3(a)(4) and 3(a)(5) of the Exchange Act to the extent that, as a conduit lender,<sup>33</sup> it engages in securities lending transactions and any securities lending services in connection with such transactions, with or on behalf of a person the bank reasonably believes to be: (1) A qualified investor as defined in Section 3(a)(54)(A) of the Exchange Act;<sup>34</sup> or (2) any employee benefit plan that owns and invests, on a discretionary basis, not less than \$25,000,000 in investments.<sup>35</sup>

<sup>31</sup> Nothing in this release should be construed as modifying the Exchange Act Section 3(a)(6) definition of “bank” as it applies to foreign banks. Currently, foreign banks generally would not meet this definition and would be considered broker-dealers under the U.S. securities laws. As such, foreign banks generally would be required to register as U.S. broker-dealers unless they qualify for an exemption from registration under Exchange Act Rule 15a-6.

<sup>32</sup> See Exchange Act Release No. 47364, *supra* note 2.

<sup>33</sup> Under Rule 15a-11 as adopted, as well as under the proposed amendment, “conduit lender” would mean a bank that borrows or loans securities, as principal, for its own account, and contemporaneously loans or borrows the same securities, as principal, for its own account.

<sup>34</sup> 15 U.S.C. 78c(a)(54)(A).

<sup>35</sup> Under Rule 15a-11 as adopted, as well as under the proposed amendment, “securities lending

As explained in the Joint Proposal, the exemption as applied to banks’ broker activities was voided by the Regulatory Relief Act. The Commission and the Board are proposing to reinstate—as Rule 772—this exemption with respect to the definition of “broker” in the Joint Proposal.<sup>36</sup> We are proposing in this release to redesignate what was Rule 15a-11 as Rule 3a5-3 and to amend former Rule 15a-11 to eliminate its applicability to a bank’s “broker” activities, while proposing to maintain its ongoing availability for a bank’s “dealer” activities. We request comment on all aspects of these changes.

### D. Proposed Withdrawal of Exchange Act Rule 3b-9, Rule 15a-8, and Rule 15a-9

We intend to withdraw Exchange Act Rule 3b-9, in which the Commission defined the term “bank” for purposes of Section 3(a)(4) and 3(a)(5) of the Exchange Act. Rule 3b-9 was invalidated by the U.S. Court of Appeals for the District of Columbia Circuit.<sup>37</sup> We also intend to withdraw Rule 15a-8, which provided a temporary exemption from Exchange Act Section 29 liability for banks’ securities activities. This exemption expired. In addition, we intend to withdraw Rule 15a-9, an exemption from the definition of “broker” and “dealer” for savings associations and savings banks. The Regulatory Relief Act caused savings associations and savings banks to be treated as “banks,” eliminating the need to differentiate between these entities for the purposes of the Exchange Act. As a result, current Rule 15a-9 is no longer necessary. We request comment on all

transaction” would mean a transaction in which the owner of a security lends the security temporarily to another party pursuant to a written securities lending agreement under which the lender retains the economic interests of an owner of such securities, and has the right to terminate the transaction and to recall the loaned securities on terms agreed by the parties. Under the proposal, “securities lending services” would mean: (1) Selecting and negotiating with a borrower and executing, or directing the execution of, the loan with the borrower; (2) receiving, delivering, or directing the receipt or delivery of loaned securities; (3) receiving, delivering, or directing the receipt or delivery of collateral; (4) providing market-to-market, corporate action, recordkeeping or other services incidental to the administration of the securities lending transaction; (5) investing, or directing the investment of, cash collateral; or (6) indemnifying the lender of securities with respect to various matters.

<sup>36</sup> As applicable to banks’ broker activities, the Rule 15a-11 exemption was never operable because of the temporary exemption applicable to all bank broker activities.

<sup>37</sup> *American Bankers Association v. SEC*, 804 F.2d 739 (1986).

aspects of withdrawing Rule 3b-9, Rule 15a-8, and Rule 15a-9.

## III. Administrative Law Matters

### A. General Request for Comments

Interested persons are invited to submit written data, views and arguments concerning this proposal. The Commission will consider the comments we previously received. Commenters may reiterate or cross-reference previously submitted comments.

### B. Paperwork Reduction Act Analysis

These proposed amendments to two rules and this re-proposal of a new rule would not impose recordkeeping or information collection requirements, or other collections of information that require approval of the Office of Management and Budget under 44 U.S.C. 3501, *et seq.* Accordingly, the Paperwork Reduction Act does not apply.<sup>38</sup>

### C. Consideration of Benefits and Costs

We believe that these two proposed rule amendments and the re-proposal of a new rule would be consistent with Congress’s intent in enacting the GLBA and would provide banks with greater legal certainty regarding their conduct with respect to securities transactions. The rule amendments and the re-proposal are very limited in scope. The Commission is re-proposing an exemption that would permit banks to purchase from and sell to non-U.S. persons securities exempt under Regulation S. The proposed rule would facilitate banks’ compliance with the federal securities laws and provide banks greater legal certainty regarding such conduct. The proposed addition of the reasonable belief standard would prevent banks from losing the exemption due to inadvertent errors in identifying the source of securities sold under the exemption, so long as the other conditions of the rule were met. We do not expect banks to incur any costs related to the re-proposal. The proposed clarifying amendment to Exchange Act Rule 15a-6 would conform the rule to the revised statutory definition of “broker” and “dealer” under the Exchange Act as well as to the rules adopted thereunder. With regard to securities lending activities, the Commission proposes to amend existing Exchange Act Rule 15a-11, and to redesignate it as Rule 3a5-3, to

<sup>38</sup> We note that, as a practical matter, banks likely already keep records that could be used to show they meet the terms of the proposed exemption. We also note that Section 203 of the GLBA specifically requires the bank regulators to promulgate recordkeeping requirements.

eliminate the rule's reference to banks' "broker" activities, and to clarify the rule's continued availability for banks' "dealer" activities. We do not expect banks to incur any costs related to these proposed amendments. The proposed withdrawal of Exchange Act Rules 3b-9 and 15a-8 reflects the invalidation of Rule 3b-9 by the U.S. Court of Appeals for the District of Columbia Circuit,<sup>39</sup> and the expiration of the 15a-8 exemption, respectively. Similarly, the proposed withdrawal of Exchange Act Rule 15a-9 is proposed because the exemption is no longer necessary after passage of the Regulatory Relief Act. Withdrawing these rules would provide administrative certainty and clarity, as rules no longer in effect would be removed from the Code of Federal Regulations. The withdrawals are administrative in effect, and thus would impose no costs. We request comments generally on the costs and benefits associated with the re-proposal, the proposed amendments, and the proposed rule withdrawals.

#### *D. Consideration of Burden on Competition, and on Promotion of Efficiency, Competition, and Capital Formation*

In accordance with our responsibilities under Section 3(f) of the Exchange Act,<sup>40</sup> we have considered both the protection of investors and whether these rule amendments and the re-proposal would promote efficiency, competition, and capital formation and have determined that they are consistent with the public interest.<sup>41</sup> In addition, Section 23(a)(2) of the Exchange Act requires us, in adopting rules under the Exchange Act, to consider the anticompetitive effects of such rules, if any, and to refrain from adopting a rule that will impose a burden on competition not necessary or appropriate in furthering the purpose of the Exchange Act.

We do not believe that the amendments and the re-proposal, as well as the elimination of Rules 3b-9, 15a-8, and 15a-9, would result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act. The proposed amendments and the re-proposal would provide guidance to

banks regarding the scope of exceptions added to the Exchange Act by Congress in the GLBA. The rule amendments and re-proposal also would not impose any additional competitive burdens on banks engaging in a securities business, other than those imposed by Congress through functional regulation in the GLBA. Further, the proposed elimination of Rules 3b-9, 15a-8, and 15a-9 is administrative in nature.

Because the types of activities that are the subject of these amendments are not the types of activities in which small banks or small broker-dealers directly participate, there should be no competitive costs to small banks or small broker-dealers.

We do not believe that those rules impose any adverse effects on efficiency, competition, or capital formation that are not a consequence of the GLBA statutory provisions. The exemptive rules would make it easier for banks to conduct their securities lending and sales of Regulation S securities after the GLBA changes to the federal securities laws. These proposed rules also would give banks enhanced legal certainty for these securities activities. We do not believe that those rules impose any adverse effects on efficiency, competition, or capital formation that are not a result of the GLBA statute. When Congress passed the GLBA, it effectively determined that regulation of banks conducting a securities operation outside of certain exceptions was necessary, appropriate, and in the public interest. Further, we believe that the proposed elimination of Rules 3b-9, 15a-8, and 15a-9 would not have any impact on efficiency, competition, or capital formation.

The Commission requests comment on whether the proposed amendments would promote efficiency, competition, and capital formation. The Commission is particularly interested in hearing whether the existence of any of the proposed bank exemptions would have a negative impact on competition. Please provide detailed information and data on exactly how banks and broker-dealers compete and how the particular exemptions would impact broker-dealers' business.

#### *E. Consideration of Impact on the Economy*

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or "SBREFA,"<sup>42</sup> the Commission must advise the Office of Management and Budget as to whether the proposed

amendments and the re-proposal constitute a "major" rule. Under SBREFA, a rule is considered "major" where, if adopted, it results or is likely to result in: An annual effect on the economy of \$100 million or more (either in the form of an increase or a decrease); a major increase in costs or prices for consumers or individual industries; or a significant adverse effect on competition, investment, or innovation. If a rule is "major," its effectiveness will generally be delayed for 60 days pending Congressional review. We request comment on the potential impact of the proposed amendments, the re-proposal, and the rule withdrawals on the economy on an annual basis. Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

#### *F. Regulatory Flexibility Analysis*

The Commission has prepared an Initial Regulatory Flexibility Analysis ("IRFA"), in accordance with the provisions of the Regulatory Flexibility Act ("RFA"),<sup>43</sup> regarding the proposed amendments and the re-proposal.

##### 1. Reasons for the Proposed Action

The Commission is proposing the amendments to address issues raised by the passage of the GLBA and the Regulatory Relief Act. In addition, the exemption in proposed Rule 3a5-2 is being re-proposed to permit banks to purchase from and sell to non-U.S. persons securities exempt under Regulation S. Finally, we are proposing the elimination of Rules 3b-9, 15a-8, and 15a-9 for administrative clarity and in conformance with the Regulatory Relief Act.

##### 2. Objectives

The proposed amendments, the re-proposal, and the proposed rule withdrawals are intended to provide legal certainty to the industry with respect to the GLBA requirements. The Commission also seeks to make the restrictions imposed by the GLBA more accommodating of current securities activities carried out by banks while preserving investor protection principles.

##### 3. Legal Basis

Pursuant to the Exchange Act and, particularly, Sections 3(a)(4), 3(b), 15, 17, 23(a), and 36 thereof, the Commission proposes to adopt the amendments and the re-proposal and to eliminate the obsolete or unnecessary rules.

<sup>39</sup> See text at note 37 *supra*.

<sup>40</sup> 15 U.S.C. 78w(a)(2). "Whenever pursuant to this title the Commission is engaged in rulemaking \* \* \* and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation."

<sup>41</sup> 15 U.S.C. 78c(f).

<sup>42</sup> Pub. L. 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C., 15 U.S.C. and as a note to 5 U.S.C. 601).

<sup>43</sup> 5 U.S.C. 603.

#### 4. Small Entities Subject to the Rule

Congress did not exempt small entity banks from the application of the GLBA. Moreover, because amendments and the re-proposal are intended to provide guidance to all banks that are subject to the GLBA, the Commission determined that it would not be appropriate to exempt small entity banks from their operation. Therefore, the amendments and the re-proposal generally apply to banks that would be considered small entities. Nonetheless, as noted above, the types of activities that are the subject of the amendments are not the types of activities in which small banks or small broker-dealers generally directly participate.

#### 5. Reporting, Recordkeeping and Other Compliance Requirements

The proposed amendments would not impose any new reporting, recordkeeping, or other compliance requirements on banks that are small entities.

#### 6. Duplicative, Overlapping, or Conflicting Federal Rules

The Commission believes that there are no rules that duplicate, overlap, or conflict with the proposed amendments.

#### 7. Significant Alternatives

Pursuant to Section 3(a) of the RFA,<sup>44</sup> the Commission must consider the following types of alternatives: (a) The establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (b) the clarification, consolidation, or simplification of compliance and reporting requirements under the proposed rule for small entities; (c) the use of performance rather than design standards; and (d) an exemption from coverage of the proposed rule, or any part thereof, for small entities.

As discussed above, the GLBA does not exempt small banks from the Exchange Act broker-dealer registration requirements, and the Commission does not believe that an unconditional exemption would be consistent with the investor protection principles of the GLBA. Moreover, such an exemption could place broker-dealers at a competitive disadvantage versus small banks.

The proposed amendments, the re-proposal and the proposed rule withdrawals are intended to clarify and simplify compliance with the GLBA. As such, the proposals should ease compliance on banks of all sizes, including smaller entities.

The Commission does not believe that it is necessary to consider whether small entities should be permitted to use performance rather than design standards to comply with the proposed amendments because they already propose performance standards and do not dictate for entities of any size any particular design standards (e.g., technology) that must be employed to achieve the objectives of the proposed amendments.

#### 8. Request for Comments

The Commission encourages written comments on matters discussed in the IRFA. In particular, the Commission requests comments on: (a) The number of small entities that would be affected by the proposed amendments; (b) the nature of any impact the proposed amendments would have on small entities and empirical data supporting the extent of the impact; and (c) how to quantify the number of small entities that would be affected by and/or how to quantify the impact of the proposed amendments. Such comments will be considered in the preparation of the Final Regulatory Flexibility Analysis, if the proposed rule is adopted, and will be placed in the same public file as comments on the proposed rule itself. Persons wishing to submit written comments should refer to the instructions for submitting comments in the front of this release.

#### IV. Statutory Authority

Pursuant to authority set forth in the Exchange Act and particularly Sections 3(a)(4), 3(b), 15, 17, 23(a), and 36 thereof (15 U.S.C. 78c(a)(4), 78c(b), 78o, 78q, 78w(a), and 78mm, respectively) the Commission proposes to repeal current Rules 3b-9, 15a-8, and 15a-9 (§§ 240.3b-9, 240.15a-8, and 240.15a-9, respectively). The Commission also is re-proposing Exchange Act Rule 3a5-2 (§ 240.3a5-2), proposing to amend Exchange Act Rule 15a-6 (§ 240.15a-6), and proposing to amend and redesignate Exchange Act Rule 15a-11 as Rule 3a5-3 (§ 240.15a-11 and § 240.3a5-3, respectively).

#### V. Text of Proposed Rules and Rule Amendments

##### List of Subjects in 17 CFR Part 240

Broker-dealers, Reporting and recordkeeping requirements, Securities.

For the reasons set forth in the preamble, Title 17, Chapter II of the Code of Federal Regulations is proposed to be amended as follows:

#### PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

1. The authority citation for Part 240 continues to read, in part, as follows:

**Authority:** 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78o, 78p, 78q, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 *et seq.*; and 18 U.S.C. 1350, unless otherwise noted.

\* \* \* \* \*

2. Sections 240.3a5-2 and 240.3a5-3 are added to read as follows:

##### § 240.3a5-2 Exemption from the definition of “dealer” for banks effecting transactions in securities issued pursuant to Regulation S.

(a) A bank is exempt from the definition of the term “dealer” under section 3(a)(5) of the Act (15 U.S.C. 78c(a)(5)), to the extent that, in a riskless principal transaction, the bank:

(1) Sells an eligible security in compliance with the requirements of 17 CFR 230.903 to a purchaser who is outside of the United States within the meaning of 17 CFR 230.903 or to a registered broker or dealer, provided that if the sale is made prior to the expiration of the distribution compliance period specified in 17 CFR 230.903(b)(2) or (b)(3), the sale is made in compliance with the requirements of 17 CFR 230.904.

(2) Purchases from a person who is not a U.S. person under 17 CFR 230.902(k) an eligible security after its initial sale with a reasonable belief that the eligible security was initially sold outside of the United States within the meaning of and in compliance with the requirements of 17 CFR 230.903.

(3) Purchases from a registered broker or dealer an eligible security after its initial sale outside of the United States within the meaning of and in compliance with the requirements of 17 CFR 230.903, and sells to a purchaser who is outside the United States within the meaning of 17 CFR 230.903.

(b) *Definitions.* For purposes of this section:

(1) *Distributor* has the same meaning as in 17 CFR 230.902(d).

(2) *Eligible security* means a security that:

(i) Is not being sold from the inventory of the bank or an affiliate of the bank; and

(ii) Is not being underwritten by the bank or an affiliate of the bank on a firm-commitment basis, unless the bank acquired the security from an unaffiliated distributor that did not

<sup>44</sup> 5 U.S.C. 603(c).

purchase the security from the bank or an affiliate of the bank.

(3) *Purchaser* means a person who purchases an eligible security and who is not a U.S. person under 17 CFR 230.902(k).

(4) *Riskless principal transaction* means a transaction in which, after having received an order to buy from a customer, the bank purchased the security from another person to offset a contemporaneous sale to such customer or, after having received an order to sell from a customer, the bank sold the security to another person to offset a contemporaneous purchase from such customer.

**§ 240.3a5-3 Exemption from the definition of “dealer” for banks engaging in securities lending transactions.**

(a) A bank is exempt from the definition of the term “dealer” under section 3(a)(5) of the Act (15 U.S.C. 78c(a)(5)), to the extent that, as a conduit lender, it engages in or effects securities lending transactions, and any securities lending services in connection with such transactions, with or on behalf of a person the bank reasonably believes to be:

(1) A qualified investor as defined in section 3(a)(54)(A) of the Act (15 U.S.C. 78c(a)(54)(A)); or

(2) Any employee benefit plan that owns and invests, on a discretionary basis, not less than \$25,000,000 in investments.

(b) *Securities lending transaction* means a transaction in which the owner of a security lends the security temporarily to another party pursuant to a written securities lending agreement

under which the lender retains the economic interests of an owner of such securities, and has the right to terminate the transaction and to recall the loaned securities on terms agreed by the parties.

(c) *Securities lending services* means:

(1) Selecting and negotiating with a borrower and executing, or directing the execution of the loan with the borrower;

(2) Receiving, delivering, or directing the receipt or delivery of loaned securities;

(3) Receiving, delivering, or directing the receipt or delivery of collateral;

(4) Providing mark-to-market, corporate action, recordkeeping or other services incidental to the administration of the securities lending transaction;

(5) Investing, or directing the investment of, cash collateral; or

(6) Indemnifying the lender of securities with respect to various matters.

(d) For the purposes of this section, the term *conduit lender* means a bank that borrows or loans securities, as principal, for its own account, and contemporaneously loans or borrows the same securities, as principal, for its own account. A bank that qualifies under this definition as a conduit lender at the commencement of a transaction will continue to qualify, notwithstanding whether:

(1) The lending or borrowing transaction terminates and so long as the transaction is replaced within one business day by another lending or borrowing transaction involving the same securities; and

(2) Any substitutions of collateral occur.

**§ 240.3b-9 [Removed and Reserved]**

3. Section 240.3b-9 is removed and reserved.

4. Section 240.15a-6 is amended by revising paragraph (a)(4)(i) to read as follows:

**§ 240.15a-6 Exemption of certain foreign brokers or dealers.**

(a) \* \* \*

(4) \* \* \*

(i) A registered broker or dealer, whether the registered broker or dealer is acting as principal for its own account or as agent for others, or a bank acting pursuant to an exception or exemption from the definition of “broker” or “dealer” in sections 3(a)(4)(B), 3(a)(4)(E), or 3(a)(5)(C) of the Act (15 U.S.C. 78c(a)(4)(B), 15 U.S.C. 78c(a)(4)(E), or 15 U.S.C. 78c(a)(5)(C)) or the rules thereunder;

\* \* \* \* \*

**§ 240.15a-8 [Removed and Reserved]**

5. Section 240.15a-8 is removed and reserved.

**§ 240.15a-9 [Removed and Reserved]**

6. Section 240.15a-9 is removed and reserved.

**§ 240.15a-11 [Removed and Reserved]**

7. Section 240.15a-11 is removed and reserved.

Dated: December 18, 2006.

By the Commission.

**Jill M. Peterson,**

*Assistant Secretary.*

[FR Doc. 06-9842 Filed 12-22-06; 8:45 am]

**BILLING CODE 8011-01-P**