

# **SECURITIES AND EXCHANGE COMMISSION**

## **17 CFR Part 240**

**Release No. 34-56502; 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:** Final rule.

**SUMMARY:** The Securities and Exchange Commission (“Commission”) is adopting 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 adopting a conditional exemption that will 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 amending and redesignating an existing exemption from the definition of “dealer” for banks’ securities lending activities as a conduit lender. In addition, the Commission is conforming a rule that grants a limited exemption from U.S. broker-dealer registration for foreign broker-dealers to the amended definitions of “broker” and “dealer” under the Exchange Act. Finally, the Commission is withdrawing three rules under the Exchange Act: a rule defining the term “bank” for purposes of the Exchange Act’s definitions of “broker” and “dealer,” due to judicial invalidation; a time-limited exemption for banks’ securities activities, due to the passage of time; and an exemption from the definitions of “broker” and “dealer” for savings associations and savings banks, as the exemption no longer necessary in light of subsequent legislation.

**Effective Date:** The final rules are effective on [INSERT 30 DAYS FROM DATE OF PUBLICATION IN THE FEDERAL REGISTER].

**For Further Information Contact:** Catherine McGuire, Chief Counsel, Linda Stamp Sundberg, Senior Special Counsel, Joshua Kans, Senior Special Counsel, John Fahey, Branch Chief, or Elizabeth K. MacDonald, Special Counsel, at (202) 551-5550, Office of Chief Counsel, Division of Market Regulation, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549.

**Supplementary Information:** The Commission is adopting new Rules 3a5-2 [17 CFR 240.3a5-2] and 3a5-3 [17 CFR 3a5-3], amending Rule 15a-6 [17 CFR 240.15a-6], and withdrawing Rules 3b-9 [17 CFR 240.3b-9], 15a-8 [17 CFR 240.15a-8], 15a-9 [17 CFR 240.15a-9] and 15a-11 [17 CFR 15a-11] under the Exchange Act.

**Table of Contents:**

- I. Introduction and Background
- II. Adopted Rules and Rule Amendments
  - A. Regulation S Transactions with Non-U.S. Persons
  - B. Amendment to Exchange Act Rule 15a-6
  - C. Securities Lending by Bank Dealers
  - D. Withdrawal of Exchange Act Rule 3b-9, Rule 15a-8, and Rule 15a-9
- III. Administrative Law Matters
  - A. Paperwork Reduction Act Analysis
  - B. Consideration of Benefits and Costs

- C. Consideration of Burden on Competition, and on Promotion of Efficiency, Competition, and Capital Formation
- D. Regulatory Flexibility Certification
- IV. Statutory Authority
- V. Text of Final Rules and Rule Amendments

## **I. Introduction and Background**

The rules and rule amendments discussed below complement Regulation R, which we are adopting jointly with the Board of Governors of the Federal Reserve System (“Board”).<sup>1</sup> These rules and rule amendments in large part reflect changes that the Gramm-Leach-Bliley Act (“GLBA”) made to the Exchange Act with respect to the status of banks as “dealers.”<sup>2</sup>

As discussed below, we are adopting Exchange Act Rule 3a5-2 to provide a conditional exemption from the definition of “dealer” to allow banks to engage in certain transactions involving securities exempted from registration by Regulation S.<sup>3</sup> We also are adopting 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. In addition, we are redesignating, as new Exchange Act Rule 3a5-3, the dealer provisions of current Exchange Act Rule 15a-11<sup>5</sup> pertaining to banks’ securities lending activities.

---

<sup>1</sup> Exchange Act Release No. 56501 (Sept. 24, 2007).

<sup>2</sup> See Exchange Act Release No. 54947 (Dec. 18, 2006), 71 FR 77550 (Dec. 26, 2006) (“Proposing Release”).

<sup>3</sup> 17 CFR 230.901 et seq.

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

<sup>5</sup> 17 CFR 240.15a-11.

Finally, we are withdrawing three rules under the Exchange Act: Rule 3b-9,<sup>6</sup> which defined the term “bank” for purposes of the Exchange Act definitions of “broker” and “dealer,” due to judicial invalidation; Rule 15a-8,<sup>7</sup> which provided a time-limited exemption for banks’ securities activities, due to the passage of time; and Rule 15a-9,<sup>8</sup> which provided an exemption from the Exchange Act definitions of “broker” and “dealer” for savings associations and savings banks, as this no longer is necessary given the passage of the Financial Services Regulatory Relief Act of 2006 (“Regulatory Relief Act”).

## **II. Adopted Rules and Rule Amendments**

### **A. Regulation S Transactions with Non-U.S. Persons**

We are adopting Rule 3a5-2, which exempts banks from the definition of “dealer” under Section 3(a)(5) of the Exchange Act for certain principal transactions involving Regulation S securities. As with Rule 771 of Regulation R, which will permit banks to engage in certain Regulation S transactions on an agency basis without being “brokers,” this rule recognizes that non-U.S. persons generally will not rely on the protections of the U.S. securities laws when purchasing Regulation S securities from U.S. banks, and that non-U.S. persons can purchase the same securities from banks located outside of the U.S.<sup>9</sup> Commenters generally supported the

---

<sup>6</sup> 17 CFR 240.3b-9.

<sup>7</sup> 17 CFR 240.15a-8.

<sup>8</sup> 17 CFR 240.15a-9.

<sup>9</sup> See Proposing Release, 71 FR at 77552. When we proposed an earlier version of this rule as part of Regulation B, we explained that these securities are not intended to be sold within the U.S. See Exchange Act Release No. 49879 (June 17, 2004), 69 FR 39682, 39720 (June 30, 2004) (explaining 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).

proposal while suggesting certain modifications and clarifications.<sup>10</sup> The rule, as adopted, incorporates changes that respond to some of these comments.

The exemption will apply only to purchases and sales of “eligible securities” – securities that are not in the inventory of the bank or an affiliate, and that are not underwritten by the bank or an affiliate on a firm commitment basis (apart from securities acquired from an unaffiliated distributor).<sup>11</sup> In addition, this dealer exemption will apply only to Regulation S transactions that a bank makes on a “riskless principal” basis.<sup>12</sup> This focus will permit U.S. banks to sell, overseas, securities that foreign banks also sell, thus helping to avoid placing U.S. banks at a competitive disadvantage with respect to eligible securities, while also helping to safeguard against investor protection risks associated with unregistered entities distributing eligible securities.

The exemption is available when a bank purchases a newly-issued eligible security from an issuer or a broker-dealer and sells that security in compliance with the requirements of Rule 903 of Regulation S<sup>13</sup> to a purchaser who is not in the U.S.<sup>14</sup> The exemption also is available

---

<sup>10</sup> See Institute of Int’l Bankers Letter (“IIB Letter”); American Bankers Ass’n Letter (“ABA Letter”); The Clearing House Association Letter (“Clearing House Ass’n Letter”).

<sup>11</sup> Rule 3a5-2(b)(2) specifically defines an “eligible security” as a security that is 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 an affiliate of the bank.

Rule 3a5-2(b)(i) defines the term “distributor” to have the same meaning as in 17 CFR 230.902(d). That provision of Regulation S defines “distributor” to mean any underwriter, dealer, or other person who participates, pursuant to a contractual arrangement, in the distribution of the securities offered or sold in reliance on Regulation S.

<sup>12</sup> Rule 3a5-2(b)(4) defines a “riskless principle 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, 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>13</sup> 17 CFR 230.903. Rule 903 of Regulation S provides that an offer or sale of securities by the issuer, a distributor, or an affiliate or a person acting on their behalf shall be deemed to occur outside the U.S. within the meaning of Rule 901 if the offer or sale is made in an offshore transaction, and no

when a bank purchases, from a person who is not a U.S. person under Rule 902(k) of Regulation S,<sup>15</sup> an eligible security after its initial sale with a reasonable belief that the eligible security was initially sold outside of the U.S. within the meaning of and in compliance with the requirements of Rule 903, and resells that security to a purchaser who is not in the U.S. or to a registered broker-dealer.<sup>16</sup> If that resale is made prior to any applicable distribution compliance period specified in Rules 903(b)(2) or (b)(3) of Regulation S,<sup>17</sup> the resale must be made in compliance with the requirements of Rule 904 of Regulation S.<sup>18</sup>

---

directed selling efforts are made in the U.S. by the issuer, a distributor, affiliate, or person acting on their behalf. Other conditions may also apply depending on the place of incorporation and reporting status of the issuer, and the amount of U.S. market interest in the securities. (Rule 901 of Regulation S generally provides that for the purposes of Section 5 of the Securities Act, the terms “offer,” “offer to sell,” “sell,” “sale” and “offer to buy” include offers and sales that occur within the U.S., but not those that occur outside the U.S.)

<sup>14</sup> Rule 3a5-2(a)(1).

<sup>15</sup> Rule 902(k) of Regulation S defines the term “U.S. person” to mean: (i) any natural person resident in the U.S.; (ii) any partnership or corporation organized or incorporated under the laws of the U.S.; (iii) any estate of which any executor or administrator is a U.S. person; (iv) any trust of which any trustee is a U.S. person; (v) any agency or branch of a foreign entity located in the U.S.; (vi) any non-discretionary account or similar account (other than an estate or trust) held by a dealer or other fiduciary for the benefit or account of a U.S. person; and (vii) any discretionary account or similar account (other than an estate or trust) held by a dealer or other fiduciary organized, incorporated, or (if an individual) resident in the U.S., and (viii) any partnership or corporation if (A) organized or incorporated under the laws of any foreign jurisdiction, and (B) formed by a U.S. person principally for the purpose of investing in securities not registered under the Act, unless it is organized or incorporated, and owned, by accredited investors (as defined in Rule 501(a)) who are not natural persons, estates or trusts.

<sup>16</sup> Rule 3a5-2(a)(2).

<sup>17</sup> Under Rule 903 of Regulation S, Category 1 encompasses certain securities: (i) issued by a foreign issuer, for which there is no substantial U.S. market interest, (ii) that are offered and sold in an overseas directed offering, (iii) that are backed by the full faith and credit of a foreign government, or (iv) that are offered and sold to employees of the issuer or its affiliates pursuant to certain foreign employee benefit plans. Category 2 encompasses securities, not eligible for Category 1, that are equity securities of a reporting foreign issuer, or debt securities of a reporting issuer or of a non-reporting foreign issuer. Category 3 applies to all offerings of securities that do not fall within Category 1 or 2.

Rules 903(b)(2) and (b)(3) of Regulation S subject Category 2 securities and Category 3 debt securities to a 40-day distribution compliance period, and subject Category 3 equity securities to a one-year distribution compliance period.

<sup>18</sup> Rule 904 of Regulation S provides that an offer or sale of securities by any person other than the issuer, a distributor, an affiliate (except an officer or director who is an affiliate solely by virtue of that position) or person acting on their behalf will be deemed to occur outside the U.S. within the meaning of

Finally, the exemption is available when a bank purchases, from a registered broker-dealer, an eligible security after its initial sale with a reasonable belief that the eligible security was initially sold outside of the U.S. within the meaning of and in compliance with the requirements of Rule 903, and resells that security to a purchaser who is not in the U.S.<sup>19</sup> This provision also requires compliance with Rule 904 if the resale is made prior to the expiration of the security's distribution compliance period.

In adopting Rule 3a5-2, we have modified the proposed rule to address concerns raised by commenters and to clarify the exemption. As revised, each section of Rule 3a5-2 specifically addresses a bank's purchase of a Regulation S security and the bank's subsequent sale or resale of the security – a structure that reflects the nature of banks' riskless principal transactions involving Regulation S securities<sup>20</sup> and helps Rule 3a5-2 better parallel the equivalent provisions of Rule 771 of Regulation R regarding banks' Regulation S transactions as agent.<sup>21</sup>

In adopting Rule 3a5-2, we have modified the proposal to provide that when the bank purchases an eligible security from a broker-dealer after the security's initial sale (for resale to a

---

Rule 901 if the offer or sale are made in an offshore transaction, and no directed selling efforts are made in the U.S. by the seller, an affiliate or person acting on their behalf. Additional conditions apply in the case of resales of Category 2 or 3 securities by dealers and persons receiving selling concessions, and in the case of resales by certain affiliates of the issuer or a distributor.

<sup>19</sup> Rule 3a5-2(a)(3).

<sup>20</sup> Paragraph (a)(1) addresses a bank's sale of newly issued Regulation S securities, paragraph (a)(2) addresses a bank's riskless principal transaction with a customer who wants to reduce or unwind a position in a Regulation S security, and paragraph (a)(3) addresses a riskless principal transaction with a customer who wants to increase or establish a position in a Regulation S security.

<sup>21</sup> As proposed, paragraph (a)(1) of the rule would have addressed a bank's sale of an eligible security, paragraph (a)(2) would have addressed a bank's purchase of an eligible security from a non-U.S. person, and paragraph (a)(3) would have addressed a bank's purchase of an eligible security from a broker-dealer together with the bank's subsequent resale.

One commenter requested that we clarify the relationship between provisions of proposed Rule 3a5-2 and proposed Rule 771. See IIB Letter (suggesting that there may be a discrepancy between Rule 771(a)(2) and Rule 3a5-2(a)(2) and asking for clarification as to whether paragraph (a)(2) of Rule 3a5-2 was intended to apply to resales).

non-U.S. person), the bank may rely on its reasonable belief that the eligible security was initially sold outside of the U.S. consistent with Rule 903. The proposed rule would have allowed a bank to rely on its reasonable belief only when it purchases a security from a non-U.S. person, but not when it purchases a security from a broker-dealer. We have made this change in light of comments we have received, as we are persuaded that the process of determining whether a security initially was issued in compliance with Regulation S would require banks to obtain the same information whether the purchase is from a broker-dealer or a non-U.S. person.<sup>22</sup>

As revised, the provisions of Rule 3a5-2 that apply to a bank's resale of previously issued Regulation S securities (but not the provision related to a bank's sale of a newly issued security) require compliance with Rule 904 of Regulation S if the resale is made prior to the expiration of the security's distribution compliance period.<sup>23</sup> We also have revised the rule to enhance its clarity and to better conform it to Regulation S.<sup>24</sup>

Commenters requested that we state that this exemption would continue to be available after the expiration of the applicable Regulation S distribution compliance period.<sup>25</sup> Commenters also questioned whether it is necessary for the rule to condition the exemption on a bank's

---

<sup>22</sup> See IIB Letter ("In both cases . . . a Bank is required to make a determination regarding the manner in which the eligible security that is the subject of the transaction was initially issued."); Clearing House Ass'n Letter. Those comments also addressed the agency provisions of Rule 771, which has been revised in a similar way.

<sup>23</sup> Specifically, the condition requiring compliance with Rule 904 is included in paragraphs (a)(2) and (a)(3) of the rule, related to a bank's resale of previously issued securities. While the condition is not included in paragraph (a)(1), related to a bank's sale of newly issued securities, because the requirements of Rule 904 are targeted to resales of Regulation S securities, a bank's sale of a newly issued security would still have to comply with Rule 903 of Regulation S.

<sup>24</sup> We are replacing the phrase "purchaser who is outside of the United States within the meaning of 17 CFR 230.903" with "purchaser who is not in the United States" to better conform to Regulation S. We also are making other technical changes, such as removing references to "broker" and Section 3(a)(4) under the Exchange Act, together with conforming changes.

<sup>25</sup> See IIB Letter (stating that the Proposing Release contained language suggesting that would not be the case); Clearing House Ass'n Letter.

compliance with Rule 904 of Regulation S if the resale is made prior to the end of the Rule 903 distribution period.<sup>26</sup> We can clarify that this rule (like Rule 771) requires the bank to meet the conditions of Rule 904 during, but not after, the distribution compliance period. During the distribution compliance period, a bank thus will have to comply with Regulation S to take advantage of the exception. Even after the end of the distribution compliance period, however, a bank may rely on this exemption from the dealer definition so long as it satisfies the other requirements of Rule 3a5-2. After the expiration of the applicable distribution compliance period, although the securities may be offered and sold in the U.S. pursuant to registration of the securities under the Securities Act or pursuant to an available exemption from the registration requirements of that Act, the bank will not be permitted to sell them to persons other than a broker-dealer or a person who is not in the United States.

One commenter stated that Rule 3a5-2 (as well as Rule 771) simply should refer to sales to a “purchaser,” rather than, as proposed, being specifically limited to sales to a purchaser who is outside the U.S.<sup>27</sup> We decline, however, to expand the exemption beyond offshore sales or sales to registered broker-dealers. Consistent with Regulation S, which permits the offshore resale of securities, the purpose of the exemption is to permit U.S. banks to sell Regulation S securities to their foreign customers. It does not permit banks to sell those securities domestically.

---

<sup>26</sup> See IIB Letter (stating that it assumed this provision merely required compliance with Regulation S to the extent applicable, and requested that we confirm that understanding, or delete the provision as unnecessary and potentially confusing).

<sup>27</sup> See IIB Letter (maintaining that the provision would be unduly restrictive by “supporting the erroneous view that the Regulation S Exemption expires once an eligible security has been seasoned,” and that the provision is unnecessary given that Rule 904 of Regulation S specifically imposes an offshore transaction requirement on resales effected prior to expiration of the applicable seasoning period).

Commenters also requested that we clarify that the definition of “eligible security” in Rule 3a5-2 (as well as in Rule 771) – which excludes any security sold from the inventory of an affiliate or that is underwritten by an affiliate on a firm-commitment basis – would not prohibit a bank from effecting Regulation S exempt transactions in securities that have been issued by an affiliate.<sup>28</sup> The “eligible security” definition in general does not exclude proprietary products such as structured notes and mutual funds that are issued by affiliates but not underwritten on a firm commitment basis. The exclusion of inventory securities and securities underwritten on a firm-commitment basis is intended to prevent banks from dumping third-party securities overseas. It is not intended to extend to all proprietary products issued by a bank affiliate. Proprietary products are sold by foreign banks, and permitting U.S. banks to sell comparable products will avoid placing U.S. banks at a competitive disadvantage with respect to those foreign banks.<sup>29</sup>

B. Amendment to Exchange Act Rule 15a-6

We are adopting, without change, a clarifying amendment to Exchange Act Rule 15a-6(a)(4)(i).<sup>30</sup> This amendment conforms Rule 15a-6 – which in general permits foreign broker-dealers to engage in certain transactions involving U.S. persons without having to register as broker-dealers – to revisions to the Exchange Act and its underlying regulations resulting from GLBA. We received no comment on the proposed amendment.

---

<sup>28</sup> See IIB Letter (“Thus, for example, a Bank could sell a structured note or other investment product (whether or not customized for the particular customer) that is issued by the Bank or an affiliate of the Bank, or shares in an offshore mutual fund controlled by the Bank or an affiliate of the Bank.”); ABA Letter.

<sup>29</sup> Although there could be higher fees associated with proprietary securities than with independent investment company securities, this also is true with respect to proprietary securities sold by foreign banks. Accordingly, we do not believe that these potentially higher fees provide a sufficient reason to exclude proprietary securities from these exemptions.

<sup>30</sup> 17 CFR 240.15a-6(a)(4)(i).

This amendment updates Rule 15a-6 to reflect the current Exchange Act definitions of “broker” and “dealer”<sup>31</sup> and their underlying rules. While the “broker” and “dealer” definitions completely excluded banks prior to GLBA, now they provide that banks engaging in the activities permitted by the conditional exceptions in those definitions “shall not be considered to be” brokers or dealers. Currently, paragraph (a)(4)(i) of Rule 15a-6 permits a foreign broker-dealer to engage in certain securities activities with a registered broker-dealer or with “a bank acting in a broker or dealer capacity as permitted by U.S. law.” As amended, that paragraph will refer to “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 . . . or the rules thereunder.”<sup>32</sup> This amendment does not change the substance of Rule 15a-6.<sup>33</sup>

---

<sup>31</sup> Exchange Act Sections 3(a)(4) and 3(a)(5), 15 U.S.C. 78c(a)(4) and (a)(5).

<sup>32</sup> Sections 3(a)(4)(B) of the Exchange Act provide exceptions from the “broker” definition for certain bank activities, while Section 3(a)(4)(E) provides an exception from that definition for banks that, prior to the enactment of GLBA, were subject to Exchange Act Section 15(e), 15 U.S.C. 78o(e), which requires certain non broker-dealer members of national security exchanges to comply with the rules that govern broker-dealers. Section 3(a)(5)(C) provides exceptions from the “dealer” definition for certain bank activities.

<sup>33</sup> A U.S. bank’s foreign affiliate could rely on Rule 15a-6(a)(4)(i) for transactions with the bank, and the bank could rely on the statutory exception regarding affiliate transactions (Exchange Act 3(a)(4)(B)(vi), 15 U.S.C. 78c(a)(4)(B)(vi)) for transactions with the foreign affiliate. Exchange Act Rule 15a-6(a)(4)(i), however, does not permit a foreign broker-dealer or bank to have direct contact with customers of the U.S. bank. Exchange Act Release No. 44291 (May 11, 2001) 66 FR 27760 (May 18, 2001). Of course, the exemptions for transactions in Regulation S securities we are adopting today (Exchange Act Rule 3a5-2 and Rule 771 of Regulation R) will permit a bank to sell Regulation S securities to non-U.S. persons, including customers of a foreign affiliate, as long as it meets the conditions of that exemption.

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. Generally, foreign banks doing business with U.S. customers will not meet this definition and would be considered broker-dealers under the U.S. securities laws. As such, foreign banks generally will be required to register as U.S. broker-dealers unless they qualify for an exemption from registration under Exchange Act Rule 15a-6.

### C. Securities Lending by Bank Dealers

We are adopting, as proposed, Rule 3a5-3 under the Exchange Act to provide banks engaged in certain securities lending transactions with a conditional exemption from the definition of “dealer.” Rule 3a5-3 incorporates the dealer provisions of Exchange Act Rule 15a-11, which we are withdrawing.<sup>34</sup>

The rule provides that a bank is exempt from the dealer definition to the extent that, as a “conduit lender,”<sup>35</sup> it engages in or effects certain “securities lending transactions”<sup>36</sup> and “securities lending services”<sup>37</sup> in connection with such transactions.<sup>38</sup> The exemption applies only to securities lending activities with or on behalf of a person that the bank reasonably

---

<sup>34</sup> In 2003, the Commission adopted Exchange Act Rule 15a-11 to provide an exemption from the definitions of both “broker” and “dealer” for banks engaging in securities lending transactions. See Exchange Act Release No. 47364 (Feb.13, 2003), 68 FR 8686 (Feb. 24, 2003) (<http://www.sec.gov/rules/final/34-47364.htm>). As applicable to banks’ broker activities, the Rule 15a-11 exemption was never operable because of the temporary exemptions applicable to all bank broker activities. The Regulatory Relief Act required the Commission and the Federal Reserve Board to jointly propose rules governing banks’ broker activities, and we are adopting Rule 772 of Regulation R jointly with the Federal Reserve Board to exempt banks from the “broker” definition for certain securities lending activities. Exchange Act Release No. 56501 (Sept. 24, 2007). The Regulatory Relief Act does not directly affect the operation of the rules the Commission adopted concerning banks’ dealer activities.

<sup>35</sup> Rule 3a5-3(d) defines the term “conduit lender” to 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. The rule further states that 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. Rule 3a5-3(d).

<sup>36</sup> Rule 3a5-3(b) defines the term “securities lending transaction” to 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.

<sup>37</sup> Rule 3a5-3(c) defines the term “securities lending services” to 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 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.

<sup>38</sup> Rule 3a5-3(a).

believes to be: (1) a qualified investor as defined in Section 3(a)(54)(A) of the Exchange Act;<sup>39</sup> or (2) any employee benefit plan that owns and invests, on a discretionary basis, not less than \$25 million in investments.

We are adopting the rule as proposed to permit banks to continue to engage in securities lending as conduit lenders, under the conditions they have followed since Rule 15a-11 became effective in 2003.<sup>40</sup> One commenter took the position – in the parallel context of banks’ agency activities – that banks should be able to engage in securities lending services for institutional customers that have less than \$25 million in investments.<sup>41</sup> We have, however, not expanded the group of persons with or on behalf of which a bank may rely on the securities lending exemption, inasmuch as we believe that the parameters of the exemption reflect banks’ existing securities lending businesses.<sup>42</sup>

Some commenters suggested exempting banks involved in securities repurchase and reverse repurchase transactions for non-exempt securities from the “dealer” definition, based on the view that repurchase and reverse repurchase activities constitute the functional equivalent of

---

<sup>39</sup> 15 U.S.C. 78c(a)(54)(A). In part, this definition encompasses corporations and partnerships with at least \$25 million in investments.

<sup>40</sup> One commenter specifically emphasized the need for a securities lending exemption to continue to apply to a bank’s conduit lending activity. See America’s Community Bankers Letter.

<sup>41</sup> See Union Bank of California Letter.

<sup>42</sup> Broker-dealers are the most frequent borrowers of securities. In this context, we note that borrowers of securities who are not qualified investors do not directly borrow securities from noncustodial banks, but instead generally borrow securities through intermediaries that would be qualified investors. The rule, however, permits banks to lend securities to employee benefit plans with at least \$25 million in investments, even though those plans do not meet all of the requirements of the “qualified investor” definition, yet are sophisticated market participants. That latter provision in part addresses industry concerns. See Letter from Edward J. Rosen, Cleary, Gottlieb, Stein & Hamilton, to Annette Nazareth, Director, Division of Market Regulation, Commission, dated Oct. 9, 2002 (requesting that the exemption encompass banks’ securities lending activity involving any entity that owns and invests on a discretionary basis at least \$25 million in investments).

financing or securities lending activities.<sup>43</sup> We and the Federal Reserve Board are soliciting comments about banks' involvement in repurchase and reverse repurchase transactions, as discussed more fully in the Joint Adopting Release. The information we receive through this process should help inform any future actions the Commission may take in this area.

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

Finally, we are withdrawing three outdated rules under the Exchange Act. No commenters addressed the proposed withdrawal of these rules.

We are withdrawing Exchange Act Rule 3b-9, in which the Commission defined the term “bank” for purposes of the Exchange Act definitions of “broker” and “dealer,” because the rule was invalidated by the U.S. Court of Appeals for the District of Columbia Circuit.<sup>44</sup> We also are withdrawing Exchange Act Rule 15a-8, which provided a temporary exemption – that has since expired – from Exchange Act Section 29 liability for banks' securities activities. In addition, we are withdrawing Exchange Act Rule 15a-9, which provides an exemption from the definitions of

---

<sup>43</sup> See ABA Letter (specifically addressing repurchase transactions involving non-exempt corporate debt; stating that while banks could provide similar financing services by converting repurchases into secured loans, they would have weaker creditor rights in bankruptcy; also stating that some investors may be permitted by governing documents to enter into repurchases, but not secured loans); Clearing House Ass'n Letter (“We note that providing financing and liquidity to customers via repurchase and reverse repurchase transactions is a traditional banking activity, and permitting banks to engage in such transactions with respect to non-exempt securities will benefit customers that do not have exempt securities against which to borrow.”); Citigroup Letter (“Given the economic equivalence between repurchase and reverse repurchase transactions and the traditional bank activity of secured lending, it is unclear why the exemption from dealer registration has been limited to transactions involving only exempted securities.”); IIB Letter (stating that repurchase transactions are the functional equivalent of securities lending, and also questioning whether these transactions actually constitute securities transactions for purposes of the GLBA push-out provisions). One commenter also urged the Commission to consider an exemption for banks engaged in repurchase transactions in an agency capacity. See Clearing House Ass'n Letter.

Banks are permitted by statutory exception to engage in purchase and sale activities with respect to exempt securities such as government securities. Exchange Act Section 3(a)(5)(C)(i)(II).

<sup>44</sup> American Bankers Association v. SEC, 804 F.2d 739 (D.C. Cir. 1986).

“broker” and “dealer” for savings associations and savings banks. The Regulatory Relief Act made Rule 15a-9 unnecessary by causing savings associations and savings banks to be treated as “banks,” thus eliminating the need to differentiate between these entities for the purposes of the Exchange Act.

### **III. Administrative Law Matters**

#### **A. Paperwork Reduction Act Analysis**

These rules and rule amendments do 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>45</sup> We received no comments on this issue.

#### **B. Consideration of Benefits and Costs**

We believe the rules and rule amendments that we are adopting are consistent with Congress’s intent in enacting the GLBA, and will facilitate banks’ compliance with the federal securities laws and provide banks with greater legal certainty regarding their conduct with respect to securities transactions. These changes are very limited in scope. Specifically, we are: (1) adopting Exchange Act Rule 3a5-2 to permit banks to purchase from and sell to non-U.S. persons and registered broker-dealers securities exempt under Regulation S; (2) adopting a clarifying amendment to Exchange Act Rule 15a-6 to conform the rule to the revised statutory definition of “broker” and “dealer” under the Exchange Act as well as to the rules adopted thereunder, without changing the substance of the exemption; (3) amending Exchange Act Rule

---

<sup>45</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 exemption. We also note that Section 203 of the GLBA specifically requires the bank regulators to promulgate recordkeeping requirements.

15a-11 to eliminate its reference to banks' "broker" activities and clarify its continued availability for banks' "dealer" activities, and redesignating it as Rule 3a5-3; and (4) withdrawing three outdated rules under the Exchange Act – Rule 3b-9 because of its invalidation by the U.S. Court of Appeals for the District of Columbia Circuit; Rule 15a-8(b) because that exemption expired on March 31, 2005; and Rule 15a-9, which is no longer necessary after passage of the Regulatory Relief Act. In light of comments received, we are adopting Rule 3a5-2 with changes to make the rule more flexible and to address technical matters. We are adopting the other rule changes as proposed. We received no comments on the costs and benefits of these rule changes.<sup>46</sup>

Rule 3a5-2, by permitting banks to purchase from and sell to non-U.S. persons and registered broker-dealers securities that are exempt under Regulation S, provides the benefit of allowing U.S. banks to engage in overseas Regulation S transactions on the same basis as foreign banks, subject to terms that are reasonably crafted to maintain appropriate standards of functional regulation and investor protection. In adopting this rule, we have liberalized the proposal to permit banks to rely on their "reasonable belief" that the securities initially were sold in compliance with Regulation S when purchasing from a broker-dealer, as well as when purchasing from a non-U.S. person. This change is intended to prevent banks from losing the exemption due to inadvertent errors in identifying the source of securities sold under the exemption. We believe that permitting banks to engage in these Regulation S transactions on a

---

<sup>46</sup> As discussed in the release adopting Regulation R, two commenters stated that the start-up and ongoing costs of complying with Regulation R will be significant, that the Agencies underestimated the amount of time associated with compliance, and that the Agencies should modify Regulation R to reduce the cost burden. See Ass'n of Colorado Trust Companies letter; Fiserv Trust Company letter. Those comments, which were general in nature, did not discuss the Exchange Act "dealer" amendments addressed here.

riskless principal basis will provide banks with competitive benefits, without imposing significant costs.<sup>47</sup>

The revisions to Rules 15a-6 and 15a-11, and the redesignation of Rule 15a-11 as Rule 3a5-3, are technical in nature to bring those rules up-to-date in light of the GLBA and the Regulatory Relief Act without changing their substance in the context of banks' dealer activities. Moreover, the withdrawal of the three outdated Rules 3b-9, 15a-8(b), and 15a-9 under the Exchange Act is administrative in effect. These changes will impose no costs and will provide administrative certainty and clarity.

C. Consideration of Burden on Competition, and on Promotion of Efficiency, Competition, and Capital Formation

Section 3(f) of the Exchange Act requires the Commission, whenever it engages in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, to consider whether the action will promote efficiency, competition, and capital formation.<sup>48</sup> In addition, Section 23(a)(2) of the Exchange Act requires the Commission, when making rules under the Exchange Act, to consider the impact such rules would have on competition.<sup>49</sup> Exchange Act Section 23(a)(2) prohibits the Commission from

---

<sup>47</sup> Under their current blanket exemption from broker registration, banks have been able to engage in economically equivalent transactions in an agency capacity. This exemption will permit banks to engage in such activities in a riskless principal capacity, without substantially changing either the costs of the activities or the benefits provided. Further, Exchange Act Rule 3a5-1 already exempts banks from acting as "dealers" for engaging in riskless principal transactions, provided that they engage in fewer than 500 such transactions per year in the aggregate under the exemption and the de minimis broker exception in Exchange Act Section 3(a)(4)(b)(vi).

<sup>48</sup> 15 U.S.C. 78w(a)(2).

<sup>49</sup> 15 U.S.C. 78c(f).

adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. We received no comment on these issues.

We do not believe that the rules and rule amendments addressed here will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act. The rules and rule amendments will provide exemptions for banks that are consistent with the exceptions added to the Exchange Act by Congress in the GLBA. They will 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. The revisions to Rules 15a-6 and 15a-11, and the redesignation of Rule 15a-11 as Rule 3a5-3, are technical in nature to bring those rules up-to-date in light of the GLBA and the Regulatory Relief Act without changing their substance in the context of banks' dealer activities. Further, the withdrawal of Rules 3b-9, 15a-8(b), and 15a-9 is administrative in nature, and will not have any impact on efficiency, competition or capital formation.

As we noted in the proposing release, the types of dealer activities that are the subject of these rules and rule amendments generally are not the types of activities in which small banks or small broker-dealers directly participate, and accordingly there will likely be little, if any, competitive costs to small banks.

We do not believe that the rules and rule amendments impose any effects on efficiency, competition, or capital formation that are not a consequence of the GLBA statutory provisions. Rule 3a5-2 and Rule 3a5-3 in particular make it easier for banks to conduct sales of Regulation S securities to persons located abroad and securities lending activities, respectively, after the GLBA changes to the federal securities laws. More generally, the rules and rule amendments also give banks enhanced legal certainty for these securities activities. Nothing in the rules and

rule amendments will adversely affect capital formation. In enacting the GLBA, Congress adopted functional regulation for bank securities activities, with certain exceptions from Commission oversight for specified activities. These rules and rule amendments are consistent with Congress' intent and make it easier for banks to comply with the requirements of the GLBA.

D. Regulatory Flexibility Certification

Pursuant to Section 605(b) of the Regulatory Flexibility Act ("RFA"),<sup>50</sup> the Commission certifies that the rules and rule amendments will not have a significant economic impact on a substantial number of small entities.

In the proposing release, the Commission requested written comments on matters discussed in the initial regulatory flexibility analysis ("IRFA"), particularly on (a) the number of small entities that would be affected by the amendments; (b) the nature of any impact the 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 amendments. We received no comments and believe that the rules and rule amendments will not have a significant economic impact on a substantial number of small entities.

**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 is repealing current Rules 3b-9, 15a-8(b), and 15a-9 (§§ 240.3b-9, 240.15a-8(b), and 240.15a-9, respectively). Pursuant to the same authority, the Commission also

---

<sup>50</sup> 5 U.S.C. 603.

is adopting Exchange Act Rule 3a5-2 (§ 240.3a5-2) adopting the amendments to Exchange Act Rule 15a-6 (§ 240.15a-6), and adopting amendments to and redesignating Exchange Act Rule 15a-11 as Rule 3a5-3 (§ 240.15a-11 and §240.3a5-3, respectively).

## V. Text of Final 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 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) Purchases an eligible security from an issuer or a broker-dealer and sells that security in compliance with the requirements of 17 CFR 230.903 to a purchaser who is not in the United States;

(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, and resells that security to a purchaser who is not in the United States or to a registered broker or dealer, provided that if the resale is made prior to the expiration of any applicable distribution compliance period specified in 17 CFR 230.903(b)(2) or (b)(3), the resale is made in compliance with the requirements of 17 CFR 230.904; or

(3) Purchases from a registered broker or dealer 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, and resells that security to a purchaser who is not in the United States, provided that if the resale is made prior to the expiration of any applicable distribution compliance period specified in 17 CFR 230.903(b)(2) or (b)(3), the resale is made in compliance with the requirements of 17 CFR 230.904.

(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 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.

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;

\* \* \* \* \*

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

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

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

\* \* \* \* \*

By the Commission.

Nancy M. Morris  
Secretary

Date: September 24, 2007