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September 1, 2004

Jonathan G. Katz
Secretary
U. S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-0609

Re: <u>Proposed Regulation B (Release No. 34-49879; File No. S7-26-04)</u>

Dear Mr. Katz:

The Institute of International Bankers (the "Institute") welcomes the opportunity to comment on Regulation B as proposed by the Securities and Exchange Commission (the "Commission").[1] Regulation B would define certain terms used in various statutory exceptions, and would provide certain exemptions, from the definition of "broker" in Section 3(a)(4) of the Securities Exchange Act of 1934 (the "Exchange Act").

We appreciate the ongoing efforts of the Commission and its staff to maintain an open dialogue with the banking industry and to implement the "push out" provisions of the Exchange Act in a manner that is consistent with the objectives of Gramm-Leach-Bliley. In general, we share in the observations and support the recommendations regarding Regulation B articulated in comment letters by domestic banking associations with respect to the "trust and fiduciary" exception and the "networking" exception. Our comments in this letter, however, focus on proposed Rule 771, which would permit U.S. banks and U.S. branches and agencies of foreign banks ("Banks") to conduct certain securities transactions on behalf of non-U.S. persons.

The Institute applauds the Commission and its staff for proposing Rule 771 and strongly urges its adoption, subject to the modifications proposed in Parts I and II below. As noted in the Proposing Release and as described more fully in our letter of May 27, 2004, an exemption such as Rule 771 will provide important but focused relief preserving the ability of Banks to provide traditional "private banking" services to non-U.S. persons. Absent this relief, these non-U.S. persons could obtain the same services from banks and other financial institutions outside the United States that are not subject to the limitations imposed by U.S. broker-dealer regulatory requirements – thus putting Banks at a significant disadvantage.

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[1] 69 Fed. Reg. 39682 (June 30, 2004) (the "Proposing Release").

By proposing Rule 771, the Commission and its staff have demonstrated innovation and flexibility in accommodating the legitimate business objectives of Banks while ensuring adequate investor protection within the Congressional mandate of Gramm-Leach-Bliley. The Commission staff should also be commended for taking the time and effort to consider the particular needs of U.S. branches and agencies of foreign banks – for whom the ability to provide "private banking" securities services to non-U.S. customers is especially important.

We respectfully request that the Commission and its staff consider the following amendments to proposed Rule 771 that are intended to clarify the scope of the Rule and to address certain practical issues that may otherwise frustrate the Rule's objectives.

I. Secondary Market Transactions.

A. Issues Arising Under Proposed Rule 771. We urge the Commission to consider modifying the treatment of secondary market transactions under the proposed exemption. As currently drafted, Rule 771 would permit a Bank to effect the resale of a security "after its initial sale within the meaning of and in compliance with the requirements of [Rule 903 of Regulation S]." Although the Institute recognizes this requirement was intended to define the scope of the exemption by reference to Regulation S, we are concerned that the proposed language could create significant practical compliance issues and legal uncertainty for Banks.

First, in most instances a Bank would have no basis for determining whether securities were initially offered "in compliance with" Rule 903. When the Bank is selling "seasoned" securities as described in the Proposing Release, those securities may have been initially offered years before by other parties without any involvement of the Bank. The Bank would have no first-hand knowledge of, or ability to assess, the steps taken to achieve compliance with the Rule. In these circumstances, the Bank's exemption from "broker" or "dealer" registration should not be placed at risk based on the failure of other parties over whom the Bank had no control to comply with Rule 903 – particularly where such noncompliance would have no impact on the manner in which the Bank currently interacts with its customers or the protections afforded such customers.

Second, the Rule appears to require that a Bank be able to demonstrate that the particular securities it is selling to or buying from customers in the secondary market were initially offered and sold under Rule 903. In many instances, however, the Bank may have no practical means for determining with certainty whether this is the case. When securities are offered both inside the United States (pursuant to a registration statement or an exemption from registration) and outside the United States under Regulation S, for example, there does not appear to be an established means for tracking over time (and post-seasoning) which securities were originally sold in which piece of the offering. A Bank engaging in secondary market trades in these securities on behalf of its foreign customers therefore ordinarily would have no ready way of determining whether the particular securities were initially sold pursuant to Rule 903.

For example, a foreign issuer may sell securities within the United States pursuant to a registration statement and outside the United States pursuant to Regulation S. After the

Regulation S securities become seasoned, they are freely tradeable within the United States and for all practical purposes interchangeable with the U.S.-offered securities.[2] Similarly, if a security is initially sold outside the United States under Regulation S, and within the United States pursuant to a private placement exemption (*e.g.*, a Rule 144A offering), the securities offered and sold under Regulation S may, prior to seasoning, be resold into the United States under Rule 144A, and the securities initially sold under Rule 144A may be resold under Regulation S and become unrestricted. Two different CUSIP numbers may be used to identify restricted verses unrestricted securities, but either of these two CUSIPs could include securities that were *not* initially offered under Regulation S.[3] Alternatively, securities may be part of a class that was sold within the United States (in a registered offering or otherwise) before or after being sold outside the United States under Regulation S. After any offshore securities have seasoned, a Bank may not be able to readily determine whether particular securities were initially part of the U.S. or the offshore offerings.

Of course, the "tracking" that appears to be required by Rule 771 would be possible if the Bank originally sells a security to a customer in compliance with Rule 903, and the customer then seeks to resell that same security through the Bank. In our view, however, it would not be appropriate to effectively limit secondary market trading under the exemption to these narrow circumstances. As both the Proposing Release and the text of Rule 771 make clear, the Commission intended the exemption to permit Banks to make secondary market *sales* to customers, not just repurchases of securities originally sold by the Bank to customers. In addition, non-U.S. investors naturally will seek to purchase previously-issued securities that are currently traded in the secondary market. Any practical limitation on Banks' ability to sell such securities would create a substantial incentive for non-U.S. investors to transfer their business to financial institutions offshore. Moreover, it would seem an odd result from a policy perspective if in effect the exemption were to permit Bank sales of *new issue* securities but restrict Bank sales of seasoned securities trading in the secondary market.

[2] We understand that the CUSIP number of the security will not explicitly designate whether it was initially sold under Regulation S. In certain circumstances it may be possible to review the applicable registration statement for a security to determine whether the registered offering was part of a global offering with a Regulation S tranche. This information would not allow the Bank to conclude, however, that the relevant securities it wishes to sell were part of that tranche. In addition, the party from whom the Bank or its customer acquired the security likely will not be able to provide the necessary "tracking" information. The same "tracking" problems arise in circumstances in which a foreign issuer registers an entire offering of securities under the Securities Act but initially sells a substantial amount of such securities under Regulation S.

[3] For example, the restricted CUSIP could include securities that were initially sold under Rule 144A (as well as securities that were originally sold under Regulation S but then resold into the United States under Rule 144A prior to seasoning). The unrestricted CUSIP could include securities that were originally sold under Rule 144A but then were resold outside the United States under Regulation S.

In addition, in certain side-by-side Regulation S and Rule 144A offerings, a single global certificate may be used, such that all securities are deemed "restricted securities." Again, there is no way of tracking whether a particular security was initially part of the Rule 144A or the Regulation S offering.

B. Potential Modifications Relating to Secondary Market Trading. The Institute has attempted to identify potential modifications to Rule 771 that would address this "tracking" issue in a manner consistent with the general scope and objectives of the Rule. We describe two such potential changes below. We would be pleased to discuss these or other possible modifications to Rule 771 with the Commission staff.

1. Resales of Foreign Securities. Rule 771 could be modified to include an exemption for resales of any "foreign security," where the term "foreign security" is defined as any security issued by a non-U.S. person if the transaction in such security is not effected on a U.S. exchange or through Nasdaq. We would propose that this exemption be *added* to the exemption currently included in Rule 771 for resales of securities initially sold under Regulation S. Thus, if a Bank is able to determine that a security was initially sold under Regulation S (such as when the Bank is repurchasing a security that it originally sold to the customer under Rule 903), it can effect a resale of that security without reference to its status as a "foreign security."

An exemption for Banks effecting resale transactions involving foreign securities would be consistent with the "offshore" and "Regulation S" focus that the Commission intended for Rule 771. First, foreign issuers are by definition "offshore" in nature, and the Bank's transactions in such issuers' securities could not be effected through the U.S. public markets on an exchange or through Nasdaq.

In addition, we note that many foreign securities are never sold into the United States – in other words, they are offered entirely under Regulation S. Those foreign securities that are offered into the United States are almost always also sold, in part at least, outside the United States under Regulation S. Although in these situations (for the reasons described above) it may not be possible to "track" whether a particular security of a foreign issuer was offered under Regulation S, many of the issuer's securities would be eligible for resale under Rule 771 as proposed if such "tracking" were in fact feasible. Explicitly permitting a Bank to effect resale transactions in any foreign securities therefore would not unduly expand the scope of securities eligible for the exemption. It is also worth noting in this regard that no investor protection or other policy objectives of Gramm-Leach-Bliley would appear to require a distinction to be drawn between Bank sales of foreign securities that were originally sold under Regulation S and Bank sales of the same securities of the same issuer and class that happened to be initially offered other than under Regulation S.

An exemption for resales of foreign securities would also be consistent with the reasonable expectations of investors and the policy considerations underlying Rule 771. In the Proposing Release the Commission noted that "non-U.S. persons will not be relying on the protections of the U.S. securities laws when purchasing Regulation S securities from U.S. banks."[4] The Commission also noted that although U.S. broker-dealer standards of conduct should apply to U.S. broker-dealers dealing with non-U.S. persons, "this principle is less

[4] 69 Fed. Reg. 39720.

compelling" when the foreign person has chosen to deal with a U.S. bank with respect to Regulation S securities."[5] The Commission further acknowledged that non-U.S. persons can buy the same securities from banks located outside the United States where they would not have the protections of U.S. law.[6] Each of these observations would continue to be true with respect to foreign securities – indeed, they are arguably *more compelling* with respect to foreign securities than for those securities of U.S. issuers that qualify under Rule 771 as proposed.

The proposed exemption for resales of foreign securities also would be generally consistent with a no-action letter regarding permissible activities of non-U.S. broker-dealers when dealing with offshore clients whose accounts are managed by U.S. resident fiduciaries.[7] That letter noted the argument that, for purposes of transactions in foreign securities, non-U.S. persons would not reasonably expect U.S. broker-dealer regulatory requirements to apply merely because their accounts are managed by a U.S. resident fiduciary. By the same token, non-U.S. persons should not reasonably expect the U.S. broker-dealer regulatory regime to apply merely because they use a Bank for transactions in foreign securities, particularly where the transaction in such securities is not effected on a U.S. exchange or Nasdaq.[8]

Finally, an exemption for resales of foreign securities would have the important virtue, as compared to the current language of Rule 771, of being much more straightforward and easier to implement for purposes of training, compliance, supervisory controls and investor education. Banks, investors and regulators will benefit from a standard that is relatively easy to understand, comply with, and audit.

2. Resales of a Class Part of Which Has Been Sold Under Regulation S. A possible alternative approach to the "tracking" problem identified above would be to permit a Bank to effect resales of a security if the Bank reasonably believes that any securities in the same class were initially sold in reliance on Regulation S.[9] Under this alternative, the securities eligible for the Rule 771 exemption would continue to be defined by reference to Regulation S. As long as the security the Bank is seeking to buy from or sell to a customer is of a class that has

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[5] Id.

[6] Id.

[7] See Cleary, Gottlieb, Steen & Hamilton (pub. avail. Jan. 30, 1996). The definition of "foreign securities" contained in this no-action letter was also used for purposes of certain additional no-action relief with respect to U.S. broker-dealer registration requirements afforded to non-U.S. broker-dealers. See Cleary, Gottlieb, Steen & Hamilton (pub. avail. Apr. 28, 1997).

[8] Indeed, the definition of "foreign securities" we have proposed for purposes of Rule 771 is somewhat *narrower* than the definition under this no-action guidance. In the no-action letter, a foreign security also would include a debt security (including a convertible debt security) issued by an issuer organized or incorporated in the United States in connection with a distribution conducted outside the United States.

[9] Although we believe it is possible that the Commission (in the adopting release or otherwise) could interpret the current language of Rule 771 to have this meaning, we would encourage modifications to the text of the Rule to make this meaning more transparent (and to deal with the problem noted in Part I.A above of requiring a Bank to determine that an offering occurred in "compliance" with Regulation S).

been issued under Regulation S, however, the Bank would not need to establish that the particular security was initially sold under Regulation S.

From the perspective of the policy objectives underlying Gramm-Leach-Bliley and the U.S. broker-dealer regulatory regime, securities that were originally sold under Regulation S should be viewed as fungible with other securities of the same class that were originally sold in another manner. Accordingly, if a Bank is permitted to effect transactions with non-U.S. customers in a security that was initially sold under Regulation S (as is currently contemplated under Rule 771), the objectives of Gramm-Leach-Bliley should not prohibit the Bank from selling an identical security of the same issuer and class merely because it was initially sold in a different manner.

We note that there are several respects in which this approach may be inferior to the exemption for transactions in foreign securities described above. For example, it would present compliance burdens for Banks, which would need to determine whether any securities within a particular class were originally sold under Regulation S. The Institute's members are in the process of reviewing potential sources of information upon which such a determination could be made. At this stage, we have not yet confirmed that Banks have readily available access to information that would permit the relevant analysis to be made in a real-time trading environment and that would integrate effectively with their compliance systems.

II. Additional Recommendations.

The Institute recommends the following additional modifications be made to Rule 771 to clarify its scope and intent.

A. Reasonable Belief Standard. We urge that a "reasonable belief" standard be incorporated into the exemption to the extent it requires a Bank to make any determinations or conduct any diligence regarding the manner in which a security has been offered. As noted above, in many instances a Bank may not have direct access to information necessary to determine whether a security was initially offered under Regulation S (the standard under Rule 771 as proposed) or part of a class that was offered under Regulation S (one alternative approach described above). The Bank may be able to obtain certain information regarding the security from third party information vendors. In other cases, the Bank may need to rely on information statements or offering memoranda, filings, or other third-party sources to determine how the security has been offered. If these sources of information are inaccurate or misleading, the Bank's exemption should not be jeopardized as long as it had a reasonable belief that the information upon which it was relying was accurate and complete.

B. Reference to Distribution Compliance Period. As proposed, paragraphs (a)(2) and (a)(3) of Rule 771 would impose the following condition on a Bank's ability to effect a secondary market trade: "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." We assume that this condition merely requires a Bank, in connection with any resale transactions, to comply with Regulation S to the extent applicable. This assumption is consistent with the Commission's statement in the Proposing Release that "after the requirements of Regulation S cease to apply to an issuance, then the bank could resell the securities…. without meeting the terms of Regulation S."[10]

If our understanding is correct, we respectfully request that the Commission confirm this in the adopting release. Alternatively, the Commission could consider deleting the language quoted above on the grounds that it is unnecessary (because the Regulation S requirements apply independently of Rule 771) and potentially confusing (because including this language may imply that the Commission intended to condition the exemption on compliance with requirements beyond what Regulation S would otherwise require).[11]

C. Definition of Eligible Security. As proposed, the definition of "eligible security" in Rule 771 would exclude any security that (i) is being sold from the inventory of the Bank or an affiliate of the Bank, or (ii) is underwritten by the Bank or an affiliate of the Bank on a firm-commitment basis. We understand the Commission included these restrictions to limit potential conflicts of interest that might create special incentives for a Bank to sell particular securities. We believe it would be useful, however, if the Commission would clarify (either in the text of the final Rule or in the adopting release) that the restriction on sales from inventory would *not* prohibit a Bank from selling securities that are being or have been *issued by* an affiliate. 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.

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We appreciate this opportunity to comment on proposed Rule 771, and reiterate our gratefulness to the Commission and its staff for their work on this exemption. As noted above, we would be pleased to discuss the matters addressed in this letter with Commission staff. Please contact the Institute if we can be of further assistance.

Very truly yours,

Lawrence R. Uhlick

Lawrence R. Uhlick
Executive Director and
General Counsel

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[10] 69 Fed. Reg. 39720.

[11] For example, no distribution compliance period applies to "Category 1" offerings, but the proposed text could be read to suggest that such a period must be applied to all secondary market trades effected pursuant to the exemption.