# INSTITUTE OF INTERNATIONAL BANKERS

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Catherine McGuire, Esq.
Chief Counsel and Associate Director
Division of Market Regulation
Securities and Exchange Commission
450 5th Street N.W.
Washington, D.C. 20549-0203

Dear Ms. McGuire:

The Institute of International Bankers (the "Institute") is writing in connection with the ongoing review by the Securities and Exchange Commission (the "Commission") of possible amendments to the interim final rules regarding the broker-dealer "push-out" requirements of the Gramm-Leach-Bliley Act (the "GLBA").[1] We respectfully request that as part of this review the Commission staff consider recommending a new exemption from the definitions of "broker" and "dealer" under the Securities Exchange Act of 1934 (the "Exchange Act") for banks that effect certain transactions for persons that are not "U.S. persons" as such term is defined in Regulation S ("Regulation S") under the Securities Act of 1933 (the "Securities Act").

We have set forth in Part I below a brief description of the existing commercial relationships and services that banks as defined in Section 3(a)(6) of the Exchange Act ("Banks"), particularly U.S. branches and agencies of foreign banks and Edge Act corporations engaged in banking,[2] have provided to non-U.S. customers. Part II sets forth in greater detail the specific terms and scope of the proposed exemption. Part III summarizes certain key legal and policy considerations in support of the proposed exemption. Finally, Part IV below requests that the Commission staff provide interim exemptive or no-action relief from the "dealer" registration requirements for Banks that comply with the proposed exemption prior to the Commission's adoption of final "push-out" rules.

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1 Exchange Act Release No. 34-44291 (May 11, 2001), 66 Fed. Reg. 27760 (May 18, 2001).

2 See 12 C.F.R. § 211.2(f).

## I. Background: Bank Securities Activities for Non-U.S. Clients.

Banks have traditionally provided a range of banking and securities-related services to non-U.S. customers. In many cases, these customers are individuals who have established a private banking relationship with a Bank through which they obtain a range of banking and related products, including lending and financing services, custody and depository services, investment advice, and trust, fiduciary and asset management services. Securities transaction services thus may constitute only one part of a broad private banking relationship through which the customer receives personalized, coordinated, and comprehensive assistance with all of his or her financial needs.

Non-U.S. customers (both retail and institutional) may choose for a variety of reasons to conduct their banking and securities activities with Banks, rather than with financial institutions in their home country or in another non-U.S. jurisdiction. For example, many non-U.S. customers have come to expect a high level of professional service when dealing with Banks. In addition, non-U.S. customers often prefer to conduct their financial activities in U.S. dollars. For Latin American investors, moreover, Banks with offices in the United States are more convenient than, for example, European banks that may be located several time zones away.

The securities transactions executed by Banks for these non-U.S. customers frequently include a broad range of instruments that are traded primarily outside the United States. In some cases, these instruments may offer foreign customers substantial tax advantages. For example, Banks often offer such customers the ability to invest in proprietary or non-proprietary offshore mutual funds that may in turn invest in U.S. or foreign securities without being subject to certain U.S. tax requirements. Moreover, some non-U.S. customers prefer offshore investments because upon the customer's death such assets may be eligible for more favorable treatment under U.S. estate taxes applicable to assets situated in the United States.

In other cases, non-U.S. customers simply may be more familiar with, or otherwise prefer, investing in securities of issuers domiciled in their geographic region or in other non-U.S. jurisdictions. Banks may offer such customers the ability to invest in European bonds or equity securities or in emerging market debt or equity securities (in the latter case, often including securities issued in a customer's geographic region). Banks may also offer non-U.S. customers with specific investment needs certain tailored investment products, such as structured notes and deposits (which may be issued by an affiliate or another entity controlled by the Bank or an affiliate) or the opportunity to invest in certain other offshore investment vehicles (including hedge funds).

## II. Terms of the Proposed Exemption.

The Institute proposes that Banks be permitted to continue to engage in certain securities transactions for non-U.S. persons without being deemed to be "brokers" or "dealers" under the Exchange Act. In particular, the Institute recommends the following exemption:

> "A bank is exempt from the definitions of "broker" and "dealer" under Sections 3(a)(4) and 3(a)(5) of the Act (15 U.S.C. 78(c)(a)(4) and (a)(5)) to the extent that, as agent or "riskless principal" (as that term is defined in §240.3a5-1), it effects
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> (a) transactions in which securities are sold to a person that is not a "U.S. person," as that term is defined in Rule 902 of Regulation S under the Securities Act of 1933, in accordance with Rule 903 of Regulation S, or
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> (b) transactions in securities after their initial issuance if the transactions are made in accordance with Regulation S or another applicable exemption from Securities Act registration and the securities are:
>
> (1) sold by a person other than a U.S. person and purchased by a person other than a U.S. person or by a registered broker or dealer, or
>
> (2) sold by a registered broker or dealer and purchased by a person other than a U.S. person."

A number of points should be noted regarding the scope and requirements of this proposed exemption:

**A. References to Provisions of Regulation S.** As noted above, the proposed exemption would refer to certain requirements of Regulation S. Regulation S provides a safe harbor from the registration requirements of the Securities Act for offshore offers and sales of securities.

**1. Initial Sales of Securities.** Rule 903 of Regulation S provides that an offer or sale of securities by an issuer, distributor, or affiliate (or any person acting on their behalf) shall be deemed to occur outside the United States if (i) the offer or sale is an "offshore transaction"[3] and (ii) the issuer, distributor, or affiliate (or any person acting on their behalf) does not engage in "directed selling efforts" in the United States.[4]

Under the proposed exemption, therefore, a Bank could act as agent or riskless principal in the initial offering or sale of securities to non-U.S. customers where the transaction satisfies the other requirements of Regulation S. For example, a Bank could sell securities that are part of a global offering involving sales to U.S. persons, provided

[3] Paragraph (h) of Rule 902 of Regulation S provides that an offer or sale is an "offshore transaction" if the offer is not made to a person in the United States and either the buyer is (or is reasonably believed by the seller to be) outside the United States when the buy order is originated or the transaction is executed on the physical trading floor of a foreign securities exchange.

[4] Paragraph (c) of Rule 902 of Regulation S defines "directed selling efforts" to mean any activities taken for the purpose, or that reasonably could be expected to have the effect, of conditioning the U.S. market for any of the securities being offered in reliance on Regulation S. Rule 903 contains additional conditions that may apply, depending upon whether there is a "substantial U.S. market interest" in the securities being offered or whether the issuer is subject to the periodic reporting requirements of the Exchange Act.

that the activities of the Bank in connection with that offering would be limited to sales to non-U.S. persons in accordance with Regulation S. The proposed exemption would not, however, permit a Bank to sell securities to a U.S. person (even where such offers may be permitted under Rule 903).

2. **Resales of Securities.** Regulation S[5] and other applicable exemptions also permit secondary market trading in securities by non-U.S. persons without registration under the Securities Act. The proposed exemption accordingly would permit a Bank to engage in transactions by or for a non-U.S. person (as defined in Regulation S), provided that the transaction complies with Regulation S or another exemption from Securities Act registration and the other side of the transaction is another non-U.S. person (or a registered broker-dealer). The proposed exemption would not cover transactions with U.S. persons other than registered broker-dealers, even in those instances in which offers to U.S. persons are permitted under Regulation S or another exemption from Securities Act registration.

We note that secondary market transactions would be eligible for the proposed exemption if they are exempt from the Securities Act registration requirements, even if they do not satisfy the "directed selling efforts" and "offshore transaction" requirements of Rule 904 of Regulation S (although particular transactions may indeed satisfy these requirements). There are several reasons why the exemption should not be conditioned on satisfying these Rule 904 requirements. Perhaps most importantly, market participants are not required to (and usually do not) monitor compliance with Regulation S requirements after the distribution compliance period (if any) under Regulation S and the 40-day period set forth in Securities Act Section 4(3) have expired (securities sold after the termination of these periods are typically referred to as "seasoned" securities). The imposition of these Regulation S requirements for transactions in seasoned securities that are not otherwise required to comply with Regulation S therefore would create potential confusion and difficulty in determining compliance with the exemption.[6]

Second, these requirements of Regulation S would not serve any policy rationale in the context of the Exchange Act definitions of "broker" and "dealer." The "directed selling efforts" prohibition is a Securities Act concept designed to prevent "conditioning" of U.S. markets and is not relevant to the Exchange Act considerations

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5 Rule 904 of Regulation S provides that an offer or sale of securities by any person other than an issuer, distributor, affiliate (except for an officer or director who is an affiliate solely by virtue of holding such position), or any person acting on their behalf shall be deemed to occur outside the United States if the offer or sale is made in an "offshore transaction" and there are no "directed selling efforts" in the United States by the seller, an affiliate, or any person acting on their behalf.

6 For example, offshore persons are unaccustomed to complying with the "directed selling efforts" restrictions when selling seasoned securities, and thus in many cases it may be difficult to determine whether such "directed selling efforts" have in fact occurred.

defining the scope of the exemption for Banks from broker or dealer status.[7] In addition, the only effect of imposing the "offshore transaction" requirement would be that a non-U.S. person must be outside the United States when an offer to sell securities to such person is made and when such offer is accepted – a result that would not appear to serve any compelling Exchange Act policy objective.[8]

Third, the imposition of the "directed selling efforts" and "offshore transaction" requirements of Regulation S in the context of the proposed exemption could create certain anomalous results. For example, a Bank may not be able to facilitate customer sales of securities (even to non-U.S. persons) if the customer (or the Bank or another entity acting on its behalf) has previously tried to sell the securities to U.S. persons (including, e.g., U.S. registered broker-dealers) and such unsuccessful efforts were deemed to constitute "directed selling efforts" for purposes of Regulation S. Restrictions on a customer's ability to dispose of securities through the Bank in reliance on this exemption obviously would create significant liquidity, pricing and other adverse consequences for the customer.

**B. Sales by and to U.S.-Registered Broker-Dealers.** As noted above, the proposed exemption would permit a Bank to act as agent or riskless principal in the sale of securities by a U.S. registered broker-dealer to a non-U.S. person (or vice-versa). The ability of a Bank to effect transactions involving U.S.-registered broker-dealers is important to providing customers with adequate liquidity and favorable pricing for their securities positions. In some cases, U.S. broker-dealers make markets in, or otherwise trade, securities that were originally offered pursuant to Regulation S. As noted above, however, the exemption would not permit a Bank to effect transactions involving U.S. persons other than U.S. registered broker-dealers, even if such transactions otherwise would be permitted under the Securities Act, such as in the case of seasoned securities.

**C. Exemption for Riskless Principal Transactions.** The proposed exemption would permit Banks to act as "riskless principals" without being deemed to be "dealers" under the Exchange Act. The ability to act as a riskless principal in these transactions, and not merely as agent, is important for a number of reasons. First, some customers (as purchasers or as sellers) may prefer to maintain confidentiality vis-à-vis their counterparties so that their trading history or investment strategies are not made known to the parties on the other sides of their transactions. In addition, some parties prefer transactions in which they take the credit risk of a Bank rather than that of another counterparty. For example, an issuer or its selling agent may prefer to sell to a Bank rather than to investors with whom they are not

[7] Prohibiting directed selling efforts in the context of seasoned securities for purposes of this exemption also would serve no purpose vis-à-vis the U.S. markets since other market participants could engage freely in such directed selling efforts.

[8] For example, the Bank could not offer to sell seasoned securities to a Latin American customer, and the Latin American customer could not accept such an offer, while visiting the bank's Miami office (even though such offer and acceptance would be permissible for Securities Act purposes). Instead, the Bank would have to wait until the customer was outside the United States before making the offer; likewise the customer could not accept the offer until he or she was outside the United States.

familiar. In certain cases, moreover, a Bank may achieve operational and pricing efficiencies by effecting a single purchase that aggregates the orders of multiple customers.

**III. Additional Rationales for Proposed Exemption.**

The proposed exemption is supported by a number of important legal and policy considerations not identified above.

**A. Consistency with the Commission's Territorial Approach to the Application of U.S. Securities Laws.** The proposed exemption would be consistent with the approach that the Commission has taken to the territorial application of the registration requirements of Section 5 of the Securities Act.[9] The Commission has required issuers to register their securities under the Securities Act "to protect the U.S. capital markets and investors purchasing in the U.S. market..."[10] Regulation S embodies this territorial approach and acknowledges the "primacy of the laws in which a market is located."[11] Purchasers and sellers of securities under Regulation S are not thought to need (or to expect) the full protection of Securities Act registration. Similarly, non-U.S. purchasers and sellers of securities that use a Bank to effect on their behalf transactions in many markets around the world do not need, and should not reasonably expect, a Bank to be subject to the full broker-dealer regulatory regime under the Exchange Act that is applicable to securities transactions in the United States.

The proposed relief would also be consistent in this respect with the no-action position taken by the Commission staff in connection with the application of broker-dealer registration requirements to foreign securities transactions entered into between a foreign dealer and a U.S. resident fiduciary acting for the account of an offshore client.[12] In granting this relief, the staff noted the argument that non-U.S. persons would not reasonably expect U.S. broker-dealer regulatory requirements to apply merely because their accounts were managed by a U.S. resident fiduciary. Similarly, non-U.S. persons should not reasonably expect the U.S. broker-dealer regulatory regime to apply merely because they have engaged a Bank to enter into transactions on their behalf that are either (i) initial offerings that are "offshore transactions" under Regulation S, or (ii) secondary market transactions with non-U.S. persons in offshore markets or with U.S. registered broker-dealers that are effected under Regulation S or otherwise exempt from Securities Act registration.[13]

**B. Avoidance of Unnecessary Disruption to Customers.** As noted above, non-U.S. customers of Banks frequently obtain a range of banking and securities services

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[9] See Securities Act Release No. 6863 (April 24, 1990), 55 Fed. Reg. 18306, 18308 (May 2, 1990) (hereinafter the "Regulation S Adopting Release").

[10] Regulation S Adopting Release, 55 Fed. Reg. at 18308.

[11] See id.

[12] See Cleary, Gottlieb, Steen & Hamilton (pub. avail. Jan. 30, 1996).

[13] By requesting the relief described in this letter, we are not addressing in any way the issue of whether and to what extent broker or dealer activities conducted outside the United States by Banks or their employees (including but not limited to activities conducted through non-U.S. offices or branches of such Banks) are otherwise subject to the registration requirements of Exchange Act Section 15.

through a "private banking" relationship with a Bank. The imposition of the "push-out" requirements to non-U.S. customers would require those customers to establish relationships with two institutions (the Bank and a broker-dealer) to receive the same services they have been receiving from the Bank and would thereby frustrate their desire to maintain a single banking relationship with one entity in which they deal with a single contact or group. It is important to note in this regard that many non-U.S. customers currently engage only in securities transactions that would qualify for the proposed exemption. Adopting the proposed exemption would therefore permit these customers to continue to conduct their investment activities without any disruption. Without the proposed exemption, these non-U.S. customers would be required to establish a new relationship with a U.S. broker-dealer even when their transactions are limited to securities traded in *offshore* markets, a seemingly incongruous result.

**C. Avoidance of Anti-Competitive Burdens on Banks.** Banks must compete with non-U.S. financial institutions that can participate freely in offshore securities markets *and* provide traditional banking services to their customers. The imposition of the "push-out" requirements to such Banks will limit their ability to offer the same range of services as these non-U.S. financial institutions. Accordingly, without the requested exemption these Banks would operate under an unfair competitive burden that could cause customers to migrate toward non-U.S. financial institutions that are in a position to provide securities products and other private banking services through a single entity. We also note that, for some of our members, the proposed exemption (together with other exemptions from the push-out requirements) would cover *all* of their securities related activities and thereby relieve them of any obligation to establish an affiliated broker-dealer. If relief is not granted, it is not clear that such firms would find it economically feasible to establish a broker-dealer affiliate solely to effect the transactions that would be covered by the proposed exemption.

**D. Supervision by Banking Regulators.** Any Bank that avails itself of the requested relief would remain subject to regulation, examination and supervision by federal and/or state banking regulators, including with respect to its private banking securities activities. This would include, for example, applicable confirmation, recordkeeping, operational and compliance requirements.[14]

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[14] See, e.g., 12 C.F.R. Part 12; 12 C.F.R. Parts, 341, 344; 12 C.F.R. §§ 208.31, 208.34. See also Board of Governors of the Federal Reserve System Examination Manuals for U.S. Branches and Agencies of Foreign Banking Organizations and for Trading and Capital-Markets Activities.

For the reasons identified in this letter, the Institute believes that the proposed exemption would be consistent with the policy objectives of the Exchange Act and the "push-out" provisions of the GLBA. We understand, however, that the Commission staff may have certain concerns that a Bank effecting transactions for non-U.S. customers could seek to sell securities that might not otherwise be appropriate for such customers in order to move such securities out of the Bank's or its affiliate's inventory or to discharge an underwriting obligation. One approach to addressing such concerns would be as follows: (i) the exemption could exclude transactions in securities that are held in the inventory of the Bank or any affiliate of the Bank; and (ii) the exemption could exclude transactions in securities that are part of offerings being underwritten on a firm-commitment basis by the Bank (including through an office outside the United States) or an affiliate of the Bank; provided, however, that the Bank could sell any such securities (on an agency or riskless principal basis) if they are acquired from an unaffiliated "distributor" that has not

**IV. Interim Relief.**

The Institute respectfully requests that the Commission staff consider granting requests for temporary no-action or exemptive relief for Banks engaging in "riskless principal" transactions that would be permitted under the proposed exemption. Under the GLBA "push out" requirements for "dealer" activities, with which Banks have been required to comply since September 30, 2003, Banks engaged in "riskless principal" transactions that would be permitted by the proposed exemption currently must rely on another exemption from "push out." It is our understanding that for these purposes such Banks generally rely on Rule 3a5-1, which permits up to 500 "riskless principal" or agency transactions per year.

These Banks may face a significant timing problem if they exhaust the 500 transaction limit of Rule 3a5-1 before the Commission completes its "push-out" rulemaking. Under such circumstances, absent interim relief, these Banks and their non-U.S. customers could be forced to cease conducting securities activities that may be fully authorized by the Commission once it completes its rulemaking. No policy rationale would be served by imposing such substantial disruption and related operational costs on Banks and their customers pending the Commission's final rulemaking.

If the proposed exemption is ultimately adopted by the Commission, this interim relief could expire upon the effective date of that exemption. If the proposed exemption is not adopted, the Commission staff could consider at that time whether it would be appropriate to make the interim relief permanent, or whether the relief should be withdrawn effective as of a date that provides Banks an adequate opportunity to restructure their "riskless principal" transactions with non-U.S. customers.

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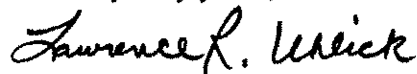
The Institute very much appreciates the Commission staff's consideration of this request. Please do not hesitate to contact the undersigned if you should wish to discuss the foregoing or if we may otherwise be of assistance.

Very truly yours,



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purchased the securities from the Bank or an affiliate of the Bank. For these purposes, the term "distributor" would have the meaning provided in Regulation S. See 17 C.F. R. § 230.902(d).