

depository institutions" under the FDIA.¹⁸

Because foreign banks cannot meet the threshold criterion for the "insured depository" exemption under Section 402, some foreign banks¹⁹ believe that Section 402 runs counter to the principle of "national treatment," which has been a fundamental goal of federal banking legislation concerning foreign banks.²⁰ Federal banking law generally permits foreign financial institutions to operate in the United States without incurring either significant advantage or disadvantage compared with U.S. financial institutions.²¹ Foreign banks have commented that the inability of foreign banks to qualify for the "insured depository" exemption places them at a disadvantage compared to their U.S. counterparts. Foreign banks have also noted that many of them are already subject in their home jurisdictions to insider lending restrictions that are similar although not identical to those imposed by Federal Reserve rules.

Some foreign banks have further commented that, under foreign banking regulations, their directors and executive officers are prohibited from borrowing money from other banks and financial institutions. In addition, although not required by local regulations, some foreign banks, like some of their U.S. counterparts, have implemented policies that prohibit senior insiders from borrowing money from other banks for the purpose of enhancing oversight and surveillance of financial transactions by insiders. The combination of these prohibitions and the provisions of Section 402 would

arguably effectively foreclose a director or executive officer of a foreign bank whose securities are registered with the Commission from borrowing money. Consequently, several foreign banks have urged the Commission to adopt an exemption for foreign banks from the Exchange Act's insider lending prohibition.

When crafting this proposed foreign bank exemption, we have attempted to strike the appropriate balance among various approaches. Subjecting foreign banks to all of the Federal Reserve System's detailed requirements in this area does not seem necessary or appropriate, especially when many foreign banking regulators have well developed regulatory schemes related to insider lending. Thus, the proposed exemption is based on principles that underlie relevant U.S. banking regulations without applying certain of the specific requirements contained in those regulations. Yet we have also striven to be specific enough to ensure that the exemption is faithful to the principles of Section 402 while giving issuers adequate guidance regarding whether the exemption is available.

Overlaying all of these concerns has been our strong commitment to implement fully the spirit of the Sarbanes-Oxley Act for all companies that are subject to the Act. We believe that our proposed foreign bank rules are consistent with the legislative intent underlying Section 402. There is little legislative history to assist in discerning Congressional intent regarding Section 402. The legislative history that does exist reveals that Section 402 was introduced in an amendment to the Sarbanes-Oxley Act just prior to its passage on July 25, 2002 in order to curb corporate corruption by preventing corporations from making personal loans to their executives.²² While there is no discussion concerning the scope of the Section 402 exemptions, there also is nothing to indicate that Congress intended to treat foreign banks differently than domestic banks. The proposed foreign bank exemption would be consistent with the Sarbanes-Oxley Act by extending Section 13(k)'s banking exemption to foreign banks but only if they meet specified criteria comparable to those required for domestic banks.

II. Discussion

A. Overview of the Proposed Foreign Bank Exemption

Proposed Rule 13k-1 would exempt from Section 13(k)(1)'s insider lending prohibition an issuer that is a foreign bank or the parent company of a foreign bank with respect to loans by the foreign bank to its insiders or the insiders of its parent company as long as:

- (1) either:
 - (a) The laws or regulations of the foreign bank's home jurisdiction require the bank to insure its deposits; or
 - (b) the Federal Reserve Board has determined that the foreign bank is subject to comprehensive supervision or regulation on a consolidated basis by its home jurisdiction supervisor under 12 CFR 211.24(c); and
- (2) the laws or regulations of the foreign bank's home jurisdiction restrict the foreign bank from making loans to its executive officers and directors or those of its parent company unless the foreign bank extends the loan:

(a) on substantially the same terms as those prevailing at the time for comparable transactions by the foreign bank with other persons who are not executive officers, directors or employees of the foreign bank or its parent company; or

(b) pursuant to a benefit or compensation program that is widely available to the employees of the foreign bank or its parent company and does not give preference to any of the executive officers or directors of the foreign bank or its parent company over any other employees of the foreign bank or its parent company; or

(c) following the express approval of the loan by the foreign bank's home jurisdiction supervisor; and

(3) for any loan that, when aggregated with the amount of all other outstanding loans to a particular executive officer or director, exceeds \$500,000:

(a) a majority of the foreign bank's board of directors has approved the loan in advance; and

(b) the loan's intended recipient has abstained from participating in the vote regarding the loan.

B. Definition of Foreign Bank

The proposed rule would employ a definition of "foreign bank" that is similar to the definition under Regulation K of the Board of Governors of the Federal Reserve System ("Federal Reserve Board").²³ Under this

¹⁸ Most foreign banks with U.S. operations are engaged in wholesale banking activities in the United States, not in the retail deposit business. See U.S. General Accounting Office, "Foreign Banks—Assessing Their Role in the U.S. Banking System," pp. 3, 5 (February 1996) ("GAO Foreign Banks Report"). These U.S. operations of foreign banks have been extensive. For example, in calendar year 2002, there were \$1.34 trillion in assets dedicated to the U.S. operations of foreign banks. During this year, only 68 (12.4%) of the 547 U.S.-based entities owned or operated by foreign banks were FDIC-insured. See the Federal Reserve Bank's "Report Regarding Structure Data for U.S. Offices of Foreign Banks as of December 31, 2002," which is available on the Federal Reserve Bank's Web site at <http://www.federalreserve.gov/releases/iba>. Of the 46 foreign banks that are currently Exchange Act reporting companies and, thus, subject to the Sarbanes-Oxley Act, only 10 have U.S.-based operations that are FDIC-insured.

¹⁹ The Commission has received several letters from foreign banks and their counsel discussing specific proposals relating to, and urging us to adopt, an insider lending exemption for foreign banks. We will make these letters publicly available along with comment letters that we will receive in response to this rule proposal.

²⁰ See, for example, the GAO Foreign Banks Report at 2.

²¹ GAO Foreign Banks Report at 16.

²² See Senator Charles Schumer's remarks in 148 Cong. Rec. S. 7350 at 7360–7361. See also Senator Carl Levin's letter to Chairman Harvey Pitt reprinted in 149 Cong. Rec. S 2178 at 2179–2180.

²³ Codified at 12 CFR 211.1 *et seq.*, Regulation K comprises the Federal Reserve Board's rules pertaining to international banking operations. Regulation K's definition of foreign bank is found at 12 CFR 211.2(j).