

I. Introduction

Section 231 of the Gramm-Leach-Bliley Act of 1999² (the “GLBA”) amended Section 17 of the Securities Exchange Act of 1934 (the “Exchange Act”) or the “Act”) to create a regulatory framework under which a holding company of a broker-dealer may voluntarily be supervised by the Commission as an SIBHC. The rules we are proposing today would create a framework for the Commission to supervise SIBHCs. These rules also would enhance the Commission’s supervision of the SIBHC’s subsidiary broker-dealers through collection of additional information and examinations of affiliates of those broker-dealers. This framework would include qualification criteria for IBHCs that file notices of intention to be supervised by the Commission, as well as recordkeeping and reporting requirements for SIBHCs. An IBHC that meets the criteria set forth in the proposed rules would not be required to become an SIBHC; supervision as an SIBHC is voluntary. Taken as a whole, the proposed framework would permit the Commission to better monitor the financial condition, risk management, and activities of a broker-dealer’s parent and affiliates on a group-wide basis. In particular, it would create a formal process through which the Commission could access important information regarding activities of a broker-dealer’s affiliates that could impair the financial and operational stability of the broker-dealer or the SIBHC.

In addition, securities firms that do business in the European Union (“EU”) have indicated that they may need to demonstrate that they have consolidated supervision at the holding company level that is “equivalent” to EU consolidated supervision.³ Generally, EU “consolidated supervision” would take the form of a series of rules, imposed at the holding company level, regarding firms’ internal controls, capital adequacy, intra-group transactions, and risk concentration. Without a demonstration of “equivalent” supervision, securities firms located in the EU have stated that they may either be subject to additional capital charges or required to form a sub-holding company in the EU.

Congress addressed these concerns by enacting Section 17(i) of the Exchange Act,⁴ which authorizes an IBHC to voluntarily elect to be supervised by the

Commission as an SIBHC.⁵ Pursuant to Section 17(i)(1)(A) of the Exchange Act, an IBHC that is not: (i) An affiliate of an insured bank (with certain exceptions) or a savings association;⁶ (ii) a foreign bank, foreign company, foreign bank branch agency, or a state-chartered commercial lending company;⁷ or (iii) a foreign bank that controls an Edge Act Corporation⁸ may elect to become an SIBHC.⁹

This regulatory framework for SIBHCs is intended to provide a basis for non-U.S. financial regulators to treat the Commission as the principal U.S. consolidated, home-country supervisor¹⁰ for SIBHCs and their affiliated broker-dealers. This would minimize duplicative regulatory burdens on broker-dealers that are active in the EU and in other jurisdictions that may have similar laws.

Under Section 17(i) of the Exchange Act, the Commission may adopt rules regarding, among other things: (i) The form of an IBHC’s notice of intention to become an SIBHC and the information and documents to be included with that notice;¹¹ and (ii) creation and maintenance of records and reports, and submission of those reports to the Commission.¹² Further, Section 17(i)(3)(C) of the Exchange Act authorizes the Commission to examine an SIBHC (including any affiliate) in order to (i) inform the Commission regarding the nature of the operations and financial condition of the SIBHC and its affiliates, the financial and operational risks within the SIBHC that may affect any broker-dealer controlled by the SIBHC, and the systems of the SIBHC and its affiliates for monitoring and controlling those risks; and (ii) monitor compliance with the provisions of Section 17(i) of the Exchange Act.¹³ Section 17(i)(3)(C) also provides that the Commission may examine the SIBHC and any affiliate to monitor compliance with the provisions of Exchange Act Section 17(i), provisions governing transactions and relationships between

any broker-dealer affiliated with the SIBHC and any of the company’s other affiliates, as well as applicable provisions of the Bank Secrecy Act [31 U.S.C. 53, subchapter II].¹⁴ While Section 17(i) of the Exchange Act authorizes the Commission to inspect any affiliate of an SIBHC, it also limits the focus and scope of any examination to the SIBHC and any affiliate of the SIBHC that, because of its size, condition, or activities, the nature or size of the transactions between such affiliate and any affiliated broker-dealer, or the centralization of functions within the holding company system, could, in the discretion of the Commission, have a materially adverse effect on the operational or financial condition of the broker-dealer.¹⁵

The rules proposed under Section 17(i) are not intended to duplicate regulation of banks, insurance companies, or futures commission merchants by other regulatory agencies. Section 17(i) of the Exchange Act directs the Commission to: (i) Accept, to the fullest extent possible, reports that an SIBHC or an affiliate thereof may have been required to provide to another appropriate regulatory agency or self-regulatory organization;¹⁶ (ii) use, to the fullest extent possible, reports of examination made by the appropriate regulatory agency or state insurance regulator;¹⁷ and (iii) defer to the appropriate regulatory agency or state insurance regulator with regard to interpretation and enforcement of banking or insurance regulations.¹⁸

II. Description of the Proposed Rules

A. Proposed Rule 17i-1: Definitions

Proposed Rule 17i-1 would incorporate the definitions set forth in Section 17(i)(5) of the Exchange Act¹⁹ into the rules promulgated under Section 17(i). Although these definitions apply regardless of whether they are incorporated into these rules, incorporating them lets individuals reading the proposed rules know that the terms are defined, and directs them to those definitions. In addition, the proposed rule includes definitions of the terms “affiliate group” and “material affiliate,” which are used

⁵ Exchange Act Section 17(i) [15 U.S.C. 78q(i)].

⁶ Exchange Act Section 17(i)(1)(A)(i) [15 U.S.C. 78q(i)(1)(A)(i)].

⁷ Exchange Act Section 17(i)(1)(A)(ii) (State-chartered commercial lending companies described in Section 8(a) of the International Banking Act of 1978 [12 U.S.C. 3106(a)]) [15 U.S.C. 78q(i)(1)(A)(ii)].

⁸ Exchange Act Section 17(i)(1)(A)(iii) (12 U.S.C. 611 (“Federal Reserve Act”), and Section 25A thereunder [12 U.S.C. 611]) [15 U.S.C. 78q(i)(1)(A)(iii)].

⁹ Exchange Act Section 17(i)(1)(A) [15 U.S.C. 78q(i)(1)(A)].

¹⁰ See *supra* note 4.

¹¹ Exchange Act Section 17(i)(1)(B) [15 U.S.C. 78q(i)(1)(B)].

¹² Exchange Act Section 17(i)(3)(A) [15 U.S.C. 78q(i)(3)(A)].

¹³ 15 U.S.C. 78q(i)(3)(C).

¹⁴ Exchange Act Section 17(i)(3)(C)(i) [15 U.S.C. 78q(i)(3)(C)(i)].

¹⁵ Exchange Act Section 17(i)(3)(C)(ii) [15 U.S.C. 78q(i)(3)(C)(ii)].

¹⁶ Exchange Act Section 17(i)(3)(B)(i) [15 U.S.C. 78q(i)(3)(B)(i)].

¹⁷ Exchange Act Section 17(i)(3)(C)(iii) [15 U.S.C. 78q(i)(3)(C)(iii)].

¹⁸ Exchange Act Section 17(i)(4) [15 U.S.C. 78q(i)(4)].

¹⁹ 15 U.S.C. 78q(i)(5).

² Pub. L. 106–102, 113 Stat. 1338 (1999).

³ See “Directive 2002/87/EC of the European Parliament and of the Council of 16 December 2002.”

⁴ See H.R. Conf. Rep. No. 106–434, 165 (1999).