

were from two banks, five bank associations, a coalition of banks, the general counsels of the Federal banking agencies, the state securities administrators' association, a pension fund, and one unknown person.¹³

Generally, the commenters supported the efforts of the Commission and its staff in listening to the concerns of the banking industry, making the dealer rules more flexible, and making banks' compliance with the dealer rules easier.¹⁴ Several commenters also generally praised the Commission and its staff for proposing the securities lending exemption to provide banks with greater legal certainty in connection with their activities as custodians, clearing agents, and noncustodial agents or intermediaries, and in facilitating securities lending and borrowing transactions.¹⁵

The General Counsels of the Federal Reserve, the OCC, and the FDIC ("the General Counsels") stated that they appreciate the efforts of the SEC reflected in the proposed rules as well as the opportunity provided to discuss how the Interim Final Rules would affect the activities and customer relationships of banks.¹⁶

Finally, one commenter noted that the proposing Release included a discussion of the background of the GLBA.¹⁷ This commenter acknowledged that the primary purpose of the federal securities laws is to protect investors and that the primary purpose of the federal banking laws is to protect the solvency of banks. The Commenter, however, stated that federal banking laws, "implement the banking laws" purpose of protecting investors."¹⁸

We note, however, that the federal securities laws are unique in providing a comprehensive, uniform, and coordinated system of regulation of securities activities under the oversight of a single expert regulator with the protection of investors as its overarching purpose.¹⁹

¹³ One comment letter was received in an unsigned and incomplete form.

¹⁴ See the First Tennessee Letter, the Coalition of Banks' Letter, the Commerce Banc Letter, the ICBA Letter, the IIB Letter, the ABA/ABASA Letter, the NYCH Letter, the NASAA Letter, and the CalPERS Letter.

¹⁵ See the Coalition of Banks' Letter, the NYCH Letter, the CalPERS Letter, the ICBA Letter, the NASAA Letter, the IIB Letter, and the ABA/ABASA Letter.

¹⁶ See the General Counsels' Letter.

¹⁷ See the NYCH Letter.

¹⁸ *Id.*

¹⁹ Among the unique investor protections provided by the federal securities laws are:

(1) Uniform qualifications and testing requirements, including continuing education, of the registered representative sales force.

The remainder of the comments dealt with specific issues related to the proposal and will be discussed in connection with the final rules, below.

IV. Dealer Activities and the Dealer/Trader Distinction

Exchange Act Section 3(a)(5) defines a "dealer" generally as a person that is "engaged in the business of buying and selling securities" for its own account through a broker or otherwise, and excepts persons, whether banks or non-banks, who do not buy or sell securities "as part of a regular business."²⁰ Therefore, banks, like other active participants in the securities markets need not register unless they satisfy these criteria.

As developed over the years, the dealer definition has been interpreted to exclude "traders." The dealer/trader distinction recognizes that dealers normally have a regular clientele, hold themselves out as buying or selling securities at a regular place of business, have a regular turnover of inventory (or participate in the sale or distribution of new issues, such as by acting as an underwriter²¹), and generally provide

(2) Explicit supervision of sales personnel through liability that is imposed on a registered broker-dealer and its supervisory personnel under statutory provisions addressing responsibility for "failure to supervise" and "controlling person liability." See Exchange Act Sections 15(b)(4)(E) and 20 [15 U.S.C. 78o(b)(4)(E) and 78t(a)]. These provisions hold broker-dealers and broker-dealer supervisory personnel responsible for the conduct of line personnel.

(3) Membership in the Securities Investor Protection Corporation (SIPC), which provides insurance in the event of broker-dealer insolvency. Missing securities and cash of investors are guaranteed up to \$500,000, including a maximum of \$100,000 for cash claims. Transactions with affiliates of SIPC insured broker-dealers, such as banks, are not covered by SIPC.

(4) Self-Regulatory Organization rules governing broker-dealer sales practices aimed at protecting investors, as well as other market-oriented rules aimed at fostering fair and competitive securities markets.

See generally Statement of the U.S. Securities and Exchange Commission Concerning Bank Securities Issues to the Subcommittee on Oversight and Investigations, Committee on Commerce, U.S. House of Representatives Testimony of Arthur Levitt, Chairman, U.S. Securities and Exchange Commission, Concerning Financial Modernization Legislation, Before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate (February 24, 1999).

²⁰ Exchange Act Section 3(a)(5) [15 U.S.C. 78c(a)(5)]. See also Proposing Release at 67 FR 67498.

²¹ The term "underwriter" is defined in Section 2(a)(11) of the Securities Act of 1933 [15 U.S.C. 77b(a)(11)]. In determining whether a bank is acting as an underwriter when it undertakes particular securities activities, the Commission is not expressing any views on whether those activities would constitute "underwriting" for purposes of Section 16 of the Glass-Steagall Act. The Commission wishes to emphasize that the determination of dealer status with respect to

liquidity services in transactions with investors (or, in the case of dealers who are market makers, for other professionals).²²

The question of whether a bank acts as a "dealer" that must register with the Commission therefore turns upon a two-stage analysis. The first stage of the analysis, which is the general "dealer/trader" distinction,²³ focuses on two factual questions: (1) Whether the bank is "buying and selling securities" for its own account; and (2) whether the bank is "engaged in the business" of that activity "as part of a regular business." A bank would not be a dealer unless both of those factual tests are met. The second stage of the analysis focuses on whether the bank can take advantage of bank-specific transactional exceptions or exemptions from the definition of dealer. If all of the bank's securities activities fall within one or more of those bank-specific exceptions or exemptions, the bank does not have to register as a broker-dealer.

We received two comments on the dealer/trader analysis that we set forth in the proposing Release.²⁴ One commenter stated: "The Release also recognized the customary distinction under the securities laws between a 'dealer' and a 'trader,' observing that 'banks may have a legitimate need to, on occasion, lend or borrow securities on their own behalf for hedging or for other reasons' and that, in such circumstances, 'they should be subject to the same dealer/trader distinction that applies to all other market participants.'" We agree wholeheartedly with all of these statements."²⁵

securities transactions, including those that do not involve a public offering, must be made by reference to the federal securities laws. It is the Commission's view, however, that the fact that an offering is exempt from registration under the Securities Act of 1933 ("Securities Act") [15 U.S.C. 77a, *et seq.*] does not necessarily affect the status of a participant in that offering as an "underwriter" as defined in Securities Act Section 2(a)(11). Furthermore, in general the determination of broker or dealer status under the Exchange Act primarily depends on the broader definitions of "purchase" and "sale." See Exchange Act Section 3(a)(13) and 3(a)(14) [15 U.S.C. 78c(a)(13) and 78c(a)(14)].

²² See, e.g., Rel. No. 34-11742 (October 5, 1975) (noting that a bank might be subject to registration as a municipal securities dealer if it engaged in underwriting, maintained a trading account or carried a dealer inventory, advertised itself as a dealer or otherwise held itself out as a dealer).

²³ A person that is buying securities for its own account may still not be a "dealer" because it is not "engaged in the business" of buying and selling securities for its own account as part of a regular business. See generally L. Loss & J. Seligman, Securities Regulation, §§ 8-A-2 and 8-A-3 nn.115 and 143 (3d ed. 2001).

²⁴ See the NYCH letter and the Coalition of Banks' letter.

²⁵ See the NYCH Letter.