

dealer, or a syndicate in which the bank is a member for some types of products.

With respect to the “dealer” exceptions, the Rules defined terms found in the asset-backed transactions exception and provided an exemption for a *de minimis* number of riskless principal transactions. In the proposing Release, we proposed amendments to those definitions as well as to the exemption for a *de minimis* number of riskless principal transactions. We also proposed a new exemption for securities lending transactions. The changes we have made in response to comments are discussed below.

A. Rule 3a5-1—the De Minimis Exemption for Riskless Principal Transactions

In the Rules, the Commission provided an exemption that permits riskless principal transactions³³ as well as brokerage transactions to be counted under the 500-transaction limit.³⁴ The proposed amendment would permit a riskless principal transaction, even if it involves two separate counterparties, to count as only one transaction against the annual 500-transaction limit.

1. Discussion of Comments Received on the Amendment to Rule 3a5-1—the De Minimis Exemption

Only two commenters addressed this exemption.³⁵ Both commenters commended the Commission for proposing to count the buy and sell components of a “riskless principal”

³³ “Riskless principal” transactions are generally described as trades in which, after receiving an order to buy (or sell) from a customer, the broker-dealer purchases (or sells) the security from (or to) another person in a contemporaneous offsetting transaction. See Exchange Act Rule 10b-10(a)(2)(ii)(A) [17 CFR 240.10b-10(a)(2)(ii)(A)]; Release No. 34-33743 (Mar. 9, 1994) at n.11.

Under the securities laws, riskless principal transactions are dealer activity. One commenter urged the Commission to adopt the position that riskless principal transactions are agency transactions and suggested that the Commission bring its views into accord with long-held banking practice. See the ICBA Letter. Because the securities laws’ interpretations of riskless principal transactions are also long-standing and specifically designed for the protection of investors, we decline to adopt the banking law view. We note that the statutory bank exceptions from the definitions of broker and dealer are limited by their terms to the statutory language, and do not extend to transactions that are the legal or economic equivalent of the statutory exceptions.

³⁴ Exchange Act Section 3(a)(4)(B)(xi) [15 U.S.C. 78c(a)(4)(B)(xi)] excepts a bank from the definition of broker if it effects no more than 500 securities transactions per calendar year, other than transactions that qualify for one of the other statutory exceptions. A transaction in which a bank is acting as an agent for a customer would count as one transaction toward the 500-transaction limit. The GLBA provisions did not extend this *de minimis* exception to dealer transactions.

³⁵ See the ICBA Letter and the IIB Letter.

transaction as one transaction for purposes of the *de minimis* exemption.³⁶

2. Amendment to Rule 3a5-1—the De Minimis Exemption

After considering the comments, we are adopting this amendment without substantive change.³⁷ We believe that this amendment will simplify the rule and make it easier for banks to understand and apply its terms to a small annual number of riskless principal securities transactions. Thus, under Rule 3a5-1, a riskless principal transaction, even if it involves two separate counterparties, would count as only one transaction against the annual 500-transaction limit.³⁸

B. Rule 3b-18—Definition of Terms Used in Asset-Backed Transaction Exception to Dealer Registration

The GLBA asset-backed exception provides that a bank may engage in the issuance or sale to qualified investors, through a grantor trust or other separate entity, of securities backed by or representing an interest in notes, drafts, acceptances, loans, leases, receivables, other obligations (other than securities of which the bank is not the issuer), or pools of any of these obligations predominantly originated by the bank, an affiliate of the bank other than a broker-dealer, or a syndicate in which the bank is a member.³⁹ As we explained when we adopted the Rules, this statutory exception only allows banks to *issue and sell* asset-backed securities to qualified investors through a grantor trust or other separate entity. It does not allow banks to *deal in* asset-backed securities. In other words, this exception is not broad enough to permit banks to regularly purchase and sell

³⁶ *Id.*

³⁷ We are, however, making a technical amendment to the rule to conform to a technical comment we received on the securities lending exemption. Because of that comment, we are changing the language of this rule. Instead of a bank being exempt, “solely for engaging in,” it will be exempt from the definition of the term dealer “to the extent that it engages in or effects,” riskless principal transactions. We are persuaded that this language more clearly sets forth the limited conduct permitted under the exemption. Although the comment was directed only to the securities lending exemption, we believe that the language of the exemptions should be consistent and are adopting this rule with this amendment.

³⁸ If, however, a bank acts as an intermediary between one counterparty and multiple counterparties by arranging multiple transactions, the bank must count each of the transactions on the side of the intermediation that involves the largest number of transactions as a separate transaction against the annual 500 transaction-limit.

³⁹ Exchange Act Section 3(a)(5)(C)(iii) [15 U.S.C. 78c(a)(5)(C)(iii)].

these securities in the secondary market.⁴⁰

Exchange Act Rule 3b-18 defines terms used in the asset-backed transactions exception to clarify the parameters of this exception. In particular, Rule 3b-18 defines the terms: “affiliate,” “consumer-related receivable,” “member of a syndicate of banks,” “obligation,” “originated,” “pool,” “predominantly originated,” and “syndicate of banks.” After consulting the banks that engage in this business and considering their business practices, we proposed amendments to some of the definitions of terms used in the asset-backed transactions exception.

In particular, we proposed expanding the definition of “originated” in Rule 3b-18(e) by considering obligations that a bank initially approves and underwrites, or agrees to purchase, to be “originated” by the bank as long as the bank meets two conditions. First, the obligation must conform to the bank’s underwriting standards or be evidenced on the bank’s documents. This requirement is intended to ensure that the bank and the entity from which it obtains the loan have an established arrangement prior to the time the loan is made to either use the bank’s underwriting standards or documentation prepared by the bank. Second, the bank must fund the obligation in a timely manner, not to exceed six months after the obligation is created.

As we explained in the proposing Release, a bank should be able to use loan origination channels such as automobile dealers, mortgage companies, and other banks, even though the bank does not “make and fund” the obligation at the exact time that the obligation is created. Conversely, a bank that purchases an obligation that does not meet the conditions of this exemption would not have “originated” the particular obligation for the purpose of meeting the test that the obligations in the pool backing an issuance of securities were predominately originated by the bank and its affiliates.

Rule 3b-18(g) defines “predominantly originated” so that a bank may engage in the issuance or sale of asset-backed securities without registration as a dealer if at least 85% of the obligations underlying the securities were originated by the bank or its affiliates, other than its broker-dealer affiliates, or any permitted syndicate of which the bank is more than an insignificant member. Specifically, the bank, its affiliates, or any such syndicate must

⁴⁰ 66 FR 27760 at 27785 (May 18, 2001).