NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.

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Jonathan Katz, Secretary
U.S. Securities and Exchange Commission
450 5th Street NW
Washington, DC 20005

RE: *SEC Release No: 34-46745: "Proposed Rule: Definition of Terms in and Specific Exemptions for Banks, Savings Associations, and Savings Banks Under Sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934."*

Dear Mr. Katz:

Please accept the following comments from the North American Securities Administrators Association (NASAA) regarding Release No: 34-46745: "Proposed Rule: Definition of Terms in and Specific Exemptions for Banks, Savings Associations, and Savings Banks Under Sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934."

In general, NASAA supports the rules detailed in the release and specifically agrees with the Commission on the following issues: (1) clarification of when a bank "predominantly originates" obligations as it relates to the asset-backed exemption; (2) only permitting the exemption from the definition of "dealer" for banks engaging in securities lending transactions to banks who, as part of their current securities business, lend securities only to Qualified Investors; and (3) the February 12, 2003 effective date for these rules. These provisions strike an appropriate balance between protecting investors and imposing reasonable regulatory obligations on banks. They also give effect to the underlying intent of GLBA: functional regulation.

Background

The Gramm-Leach-Bliley Act of 1999 (GLBA) permits banks to engage in certain securities activities that were previously prohibited by the Glass-Steagall Act. Because Congress supported "functional regulation," GLBA amended the Securities and Exchange Act of 1934 to eliminate the blanket exclusion of banks from the definitions of "broker" and "dealer." Functional regulation essentially means that the government agency with expertise in regulating particular activities does so regardless of the business entity conducting those activities. This is in recognition of the principle that investors should receive similar protections whether they purchase securities from a bank or a registered broker-dealer.

Although GLBA removed the blanket exemptions, certain activities of banks remained exempted from the definition of "dealer". Thus, the following four activities involving the sale and purchase of securities for a bank's own account were excluded from the definition:

- Transacting securities business for the bank's own investment purposes;

- Purchase and sale of exempted securities, Canadian Obligations, and Brady Bonds;
- Purchase and sale of Identified banking products; and
- Sale of asset-backed transactions to Qualified Investors.

The SEC's interpretation of these exemptions as detailed in SEC Release No. 34-46745 is of interest to the states because states regulate dealers. Congress affirmed that states have an important role in the effective functional regulation of entities that choose to sell or buy securities. Congress therefore preserved state securities regulation of banks in GLBA Section 104(f).[1] State regulators agree with Congress and the Commission that banks that engage in securities activities should be subject to the securities laws designed to protect investors, but also agree that certain limited securities activities conducted by banks should not give rise to a requirement that banks register as dealers. The NASAA 2002 Uniform Securities Act Project Group and states that have considered state securities legislation subsequent to GLBA have deferred to the GLBA dealer exemptions[2]. It follows that states who defer to the GLBA dealer exemptions will follow the SEC rules proposed in Release No. 34-46745.

The Asset-Backed Transaction Exemption to Dealer Registration

The asset-backed exemption allows a bank to create, issue, and sell through a grantor trust or other separate entity asset-backed securities predominantly originated by the bank and its affiliates. NASAA agrees with the SEC's proposal to define "predominantly" in terms of 85% of loan production origination. This approach is consistent with other provisions in GLBA and the intent of Congress. For example, Section 103(n)(2) of GLBA, modifying the Bank Holding Act, expressly provides that a firm is "predominantly" engaged in "financial activities" when at least 85 percent of the annual gross revenues of the consolidated company derive from financial activities, excluding any revenue from banks. It is thus consistent with other parts of GLBA to similarly define "predominantly" as it modifies "originates" by using the 85 percent threshold for loan product origination. This allows banks to have the legal certainty they require, while at the same time closing a potential loophole for banks seeking to act as dealers of securities for loans originated by other entities.

[1] 104(f) Limitation – Subsections (c) and (d) shall not be construed to affect – (1) the jurisdiction of the securities commission or any agency or office performing like functions of any State, under the laws of such State (B) to require the registration of securities or the licensure or registration of brokers, dealers or investment advisers[ ].

[2] Under the definitions section of the new USA "Broker-dealer" means a person engaged in the business of effecting transactions in securities for the account of others or for the person's own account. The term does not include:

(A) an agent;

(B) an issuer;

(C) a bank or savings institution if its activities as a broker-dealer are limited to those specified in subsections 3(a)(4)(B)(i) through (vi), (viii) through (x), and (xi) if limited to unsolicited transactions; 3(a)(5)(B); and 3(a)(5)(C) of the Securities Exchange Act of 1934 (15 U.S.C. Sections 78c(a)(4) and (5)) or a bank that satisfies the conditions described in subsection 3(a)(4)(E) of the Securities Exchange Act of 1934 (15 U.S.C. Section 78c(a)(4));

(D) an international banking institution; or

(E) a person excluded by rule adopted or order issued under this [Act].

The Exemption From the Definitions of "Broker" and "Dealer" for Banks Engaging in Securities Lending Transactions

Under GLBA, the exemption for "banks engaging in securities lending transactions" only applies when banks have custody of the securities. The Commission proposes extending the exemption to banks that engage in securities lending transactions when the banks do not have custody of the securities. Banks that engage in such activities are primarily acting in an agency capacity, although they sometimes may engage in securities lending as principal while acting as a conduit between two parties, providing credit intermediation between the lender and borrower.

NASAA agrees with the Commission's decision to expand the exemption but to do so only with respect to transactions involving Qualified Investors. Banks that engage in these types of transactions with Qualified Investors and conduct no other business that would otherwise require them to register as a dealer should not be required to register. The Commission's requirement that a bank enter into a written securities lending agreement with the Qualified Investor is a check that the bank is truly acting solely as an agent. The limitation of the exemption to Qualified Investors helps minimize the risk of harm to less sophisticated investors.

The Commission's limitation of the exemption to a bank's current securities lending business also is wise. Very few companies now provide these types of services. Qualified Investors who borrow securities from these companies do not need the protection afforded by dealer registration. The SEC should similarly scrutinize companies that desire to engage in this activity in the future.

The Effective Date of February 12, 2003

GLBA provided that the amendments to the Exchange Act definitions were to be effective May 12, 2001. The Commission adopted interim final rules on May 11, 2001, but granted a temporary exemption from registration until October 1, 2001. The effective date subsequently was further extended. On May 8, 2002, the Commission extended the temporary exemption from the definition of "dealer" to November 12, 2002. In Release No. 34-46745, the temporary exemption is extended until February 12, 2003.

NASAA agrees with this effective date and believes there should be no further extensions. Three and one-half years after the passage of GLBA is ample time to adapt to repeal of Glass-Steagall and functional regulation.

Some commentators have suggested that the Commission should delay the effective date of the dealer exemptions until the broker rules are completed. We believe there is no persuasive reason to delay effectiveness of these narrowly tailored exemptions to the definition of dealer. If a bank is engaged in buying and selling securities for its own account as part of its regular course of business, it should be required to register as a dealer unless it meets one of the stated exemptions. Neither the current rules nor the final rules exempting certain banks from having to register as a *broker* will change that bank's duty to register as a *dealer*.

These rules strike a careful balance between providing investors with the same protections wherever they purchase securities, while not unnecessarily disturbing certain bank securities activities. If I can be of any assistance in implementing these rules, please call me at (207) 624-

8555 or you may call Tanya Solov, Chair of NASAA's Financial Modernization Project Group at (312) 793-2525.

Sincerely,

Christine A. Bruenn
President