April 9, 2002

Ms. Christine A. Bruenn
Securities Administrator
State of Maine
Department of Professional and Financial Regulation
Bureau of Banking, Securities Division
121 State House Station
Augusta, Maine 04333-0121

Re: Securities Exchange Act of 1934 Section 3(a)(4)

Dear Ms. Bruenn:

In your letter dated December 4, 2001, you requested guidance from the staff regarding the application of the bank exception from the definition of "broker" in Section 3(a)(4) of the Securities Exchange Act of 1934 ("Exchange Act"). In particular, you asked whether nonbank subsidiaries of banks are considered "banks," and thus would be excepted from the definition of "broker" when they enter into networking arrangements with broker-dealers pursuant to Exchange Act Section 3(a)(4)(B)(i). You note that some nonbank subsidiaries of banks may be entering into networking arrangements with broker-dealers, and indicate that this may be an attempt, at least in part, to limit potential liability to the bank arising out of its securities activities.

Prior to May 12, 2001, Exchange Act Section 3(a)(4) defined a "broker" as "any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank."[1] The Gramm-Leach-Bliley Act amended the Exchange Act's definitions of "broker" by replacing the general exception for banks with specific functional exceptions from broker-dealer registration for certain bank securities

[1] 15 U.S.C.§ 78c(a)(4).

activities.[2] These exceptions are only available to a "bank." The definition of "bank" in the Exchange Act was not changed by the Gramm-Leach-Bliley Act."[3]

Exchange Act Section 3(a)(6) defines a "bank" as:

> (A) a banking institution organized under the laws of the United States, (B) a member bank of the Federal Reserve System, (C) any other banking institution, whether incorporated or not, doing business under the laws of any State or of the United States, a substantial portion of the business of which consists of receiving deposits or exercising fiduciary powers similar to those permitted to national banks under the authority of the Comptroller of the Currency pursuant to the first section of Public Law 87-722 (12 U.S.C. 92a), and which is supervised and examined by State or Federal authority having supervision over banks, and which is not operated for the purpose of evading the provisions of this title, and (D) a receiver, conservator, or other liquidating agent of any institution or firm included in clauses (A), (B), or (C) of this paragraph.

Exceptions or exemptions from broker-dealer registration for persons engaged in brokerage activity are construed narrowly.[4] For example, the Exchange Act provides a narrow exception from broker-dealer registration for broker-dealers whose business is exclusively intrastate.[5]

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[2] Pub. L. No. 106-102, 113 Stat. 1338 (1999). The Gramm-Leach-Bliley Act also amended the definition of "dealer" in Exchange Act Section 3(a)(5). 15 U.S.C.§ 78c(a)(5). While the amended Exchange Act definitions became effective on May 12, 2001, the Commission extended their effective date until May 12, 2002. See Order Extending Temporary Exemption of Banks, Savings Associations, and Savings Banks from the Definitions of "Broker" and "Dealer" under Sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934; Notice of Intent to Amend Rules, Exchange Act Rel. No. 44570 (July 18, 2001).

[3] Although the Gramm-Leach-Bliley Act did not amend the definition of "bank," the Commission extended the bank exception from broker-dealer registration to savings associations and savings banks. See Definition of Terms 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, ("Definition of Functional Regulation Terms") Exchange Act. Rel. No. 44291 (May 11, 2001), 66 FR 27760 (May 18, 2001) (exemption to be codified at Exchange Act Rule 15a-9).

[4] The Commission has authority to issue orders exempting entities from broker-dealer registration, but has used this authority rarely and only under special circumstances. At present only two entities have exemptions from broker-dealer registration. One is American Federal Express Travel Related Services, which has an exemption that allows it to accept and direct payments for annuity products to an affiliated broker-dealer. Exchange Act Rel. No. 43617 (Nov. 24, 2000). The second is the National Association of Investors Corp. ("NAIC"), which has an exemption to allow it to operate an investment plan investing exclusively in corporations operating dividend reinvestment plans. See Letter re: NAIC (June 1, 1979).

[5] As one commentator noted, the intrastate exemption is narrow. See Steven Lofchie, A Guide to Broker-Dealer Registration, 36 (Compliance International Inc. 2000) ("As interpreted by the SEC, the intrastate exemption is extremely narrow . . ."); see also, VI LOUIS LOSS AND JOEL SELIGMAN, SECURITIES REGULATION, 8.A. (3rd ed. 1990) (explaining how strictly the Commission has interpreted the exception for intrastate brokers from broker-dealer registration).

Consistent with this approach, the Commission staff has historically construed the bank exception from broker-dealer registration as only applicable to banks, and not to bank affiliates, except when a financial regulator requires a bank to establish a service corporation to enter into a networking arrangement.[6] The Commission has cited this approach with approval. When the Commission defined terms in Exchange Act Section 3(a)(4)(B)(i), it noted that the networking exception from broker-dealer registration as amended by the Gramm-Leach-Bliley Act follows a long line of letters issued by the Commission staff regarding these types of arrangements.[7] As noted above, the staff has consistently stated in these letters that use of a service corporation to enter into networking arrangements with broker-dealers was permissible only "*where required by the laws or regulations governing a Financial Institution . . . .*"[8] In other words, the staff permitted networking arrangements to run between a service corporation and broker-dealer *only if another regulator requires use of a service corporation.*

Please contact me at (202) 942-0061 if you have additional questions concerning these issues.

Very truly yours,

Catherine McGuire
Chief Counsel

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[6] See, e.g., Letter re: Chubb Securities Corp. (Nov. 24, 1993) ("Chubb Letter"). The Chubb Letter superseded prior staff positions regarding these arrangements. See also Letters re: Invest Financial Corp. (Aug. 27, 1993) (no-action relief from Exchange Act Section 15(a) for financial institutions, and, when required by law, their service corporations); Independent Financial Securities, Inc. (June 7, 1993) (same); Bankers Financial Partners, Inc. (May 14, 1993) (same); UVEST Financial Services Corp. (Nov. 24, 1992) (same); Liberty Securities Corp. (Oct. 21, 1992) (same); MidAmerica Management Corp. (July 16, 1992) (same). The staff also issued a no-action position under Exchange Act Section 15(a) to allow a savings and loan holding company to enter into an insurance networking arrangement with a registered broker-dealer based on counsel's representation that the federal savings bank affiliate was prohibited by applicable regulations of the Office of Thrift Supervision from entering into networking arrangements directly. See Letter re: The Somerset Group, Inc. (Dec. 20, 1996).

[7] Definition of Functional Regulation Terms, supra note 3, 66 FR 27765 n. 38.

[8] Letter re: Chubb Securities Corp., supra note 8 (emphasis added). As the Commission stated, the Chubb Letter will remain in effect for required service corporations of savings associations and savings banks; however, the Chubb Letter is available only to service corporations so long as a savings association or savings bank is required by law or regulation to use one. A savings association or savings bank that complies with the terms of the networking exception will automatically comply with the terms of the Chubb Letter. See id.