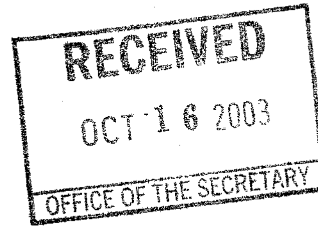
#/

SHEARMAN & STERLING LLP

FAX: 212-848-7179
TELEX: 667290 WUI
www.shearman.com

599 LEXINGTON AVENUE
NEW YORE, N.Y. 10022-6069
212 848-4000



ABU DHABI
BEIJING
BRUSSELS
DÜSSELDORF
FRANKFURT
HONG EONG
LONDON
MANNHEIM
MENLO PARE
MUNICH
NEW YORK
PARIS
ROME
SAN FRANCISCO
SINGAPORE
TOHYO
TORONTO
WASHINGTON, D.G.

WRITER'S DIRECT NUMBER:

(212) 848-8060

October 15,2003

Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20549

Attention: Jonathan G. Katz, Secretary

File No. S 7-15-03
Release No. 34-48481
International Series Release No. 1272
Comments on Proposed Rule 13k-1

Dear Sir:

We appreciate the opportunity to comment on some aspects of proposed Rule 13k-1 (the "Rule") promulgated under Section 13(k) of the Securities Exchange Act of 1934, as amended (the "Securities Exchange Act").

1. Definition of Foreign Bank, Rule 13k-1(a)

(a) We accept the basic proposition that the group of foreign banks exempted from Section 402 of the Sarbanes-Oxley Act of 2002 ("SO Act") must be comparable to the group of U.S. banks exempted from the prohibition of Section 402 of the SO Act.

(b) It appears to us, however, that *foreign* ***hank*** is defined more restrictively than is necessary to create comparability with insured depository institutions as defined in Section 3(c)(1) & (2) of the Federal Deposit Insurance Act ("FDIC Act"), § 12 U.S.C. 1813(c)(1) & (2), which are excepted from the prohibition of Section 402 of the SO Act (Section 13(k)(1) of the Securities Exchange Act). It seems to us that it is sufficient to require that the foreign bank be regulated as a bank in its home jurisdiction and be engaged in the business of banking. *See* Rule 13k-1(a)(1).

Shearman & Sterling LLP is a limited liability partnership organized in the United States under the laws of the State of Delaware, which laws limit the personal liability of partners.

We do not see any justification for the additional requirements under Rule 13k-1(a)(3) as to the type of business in which such foreign bank is engaged. There are many foreign banks that are licensed and regulated as banks but that do not receive deposits or take deposits only to a minor extent as a convenience for their corporate customers.[1] In many foreign bank regulatory systems, the power to take deposits and the actual taking of deposits are not of significance for the application of banking laws and regulations or for the scope of supervision by bank regulatory agencies.[2] As you know, deposit-taking has become a far less important

---

[1] For instance, Section 1(3d) of the German Banking Act defines a depository institution as an institution that takes deposits or finances itself through issuance of the debt securities in the capital markets. ***See*** Karl-Heinz Boos, Reinfried Fischer & Hermann Schulte-Mattler, KREDITWESENGESETZ, § 1, Margin Number 173 (2000). The European Union Directive 2000/12/EC of the European Parliament and of the Council of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions. Eur. Comm. O.J. L. 126/1 (2000), defines in Art. **1(a)** *credit institution* as an undertaking whose business is to receive deposits or *other repayable funds* from the public. The Directive is the legal basis for Section 1 (3d) of the German Banking Act and one must assume that Section 1(3d) of the German Banking Act correctly interprets Art. 1(a) of the Directive.

Certain German banks that operate as state development banks by supporting one or more German states in the fulfilment of their public functions and providing financing and **support** for the execution of the states' development activities do not accept deposits from the public at large. Under Rule 13k-1(a)(3), such banks would, thus, not be deemed to be engaged in the business of banking, would not qualify as ***foreign bank*** and would not fall within the scope of the proposed exemption, although they are licensed as banks and are subject to the same regulations and supervision as commercial banks in Germany.

In addition, the German Deposit-Protection and Investor Compensation Act (*(Einlagensicherungs- und Anlegerentschädigungsgesetz)* requires not only institutions that accept deposits but also institutions that engage in certain other banking or financial services activities to insure their deposits and liabilities by participating in a compensation scheme. *See* Section 1(1) of the Deposit Protection and Investor Compensation Act which contains the definition for "Institution" within the meaning of that Act, and Section 2 which contains the obligation to insure deposits and liabilities from securities transactions. ***See*** Boos, Fischer & Schulte-Mattler, KREDITWESENGESETZ, *supra*, § 23a, Margin Number 2. The legal basis for the Act is Directive 1994/19/EC of the European Parliament and of the Council of 30 May 1994 on deposit-guarantee schemes, O.J. Eur. Comm. No. L 135/5 (1994) and Directive 97/9/EC of the European Parliament and of the Council of 3 March 1997 on investor-compensation schemes, O.J. Eur. Comm. No. L 84/22 (1997).

[2] For instance, under the German Banking Act (*Gesetz über das Kreditwesen*), an institution that conducts any of certain enumerated banking activities, automatically becomes subject to the restrictions and requirements of the Banking Act. Thus, even though some banks do not accept deposits in their regular course of business, they are still subject to virtually all rules and regulations applicable to German banking institutions that do receive deposits and they must comply with all standards prescribed for the banking industry. See Michael Gruson, *Banking Regulation and Treatment of **Foreign** Banks in Germany,* ch. 8 in Gruson & Reisner, REGULATION OF FOREIGN BANKS – UNITED STATES AND INTERNATIONAL Vol. 2, 3d ed. 2000, at § 8.03 ("Gruson, Banking Regulation in Germany"). Only very few provisions of the German Banking Act apply solely to deposit-taking institutions. For instance, the limitation on a substantial investment in enterprises other than a bank, financial enterprise or insurance company to 15 percent of Tier I and Tier II capital, and on all such substantial investments to 60 percent of such capital, is limited to deposit-taking institutions. Section 12 of the German Banking Act. ***See*** Gruson, Banking Regulation in Germany, *supra,* § 8.15. Substantially all provisions of the German Banking Act apply to all credit institutions whether or not they take deposits. Notably the restrictions on loans to officers and directors are not limited to deposit-taking institutions. Section 15 of the German Banking Act. The German Bank Supervisory Authority has said that any institution that has a full banking license is a deposit-taking institution, regardless of whether or not it **takes** deposits. Letter of Dec. 30, 1994 (I3-113A-1/94). For

source of funding than it used to be. There is no reason why a bank that finances itself (mainly or exclusively) in the capital market should not have the benefits of Rule 13k-1.

Furthermore, the deposit requirement adds many interpretative issues that will take **up** much time and effort of the foreign banks and the SEC's staff, although they have little relevance to the purpose of Section 402 of the SO Act. For instance: are interbank deposits deposits for purposes of Rule 13k-1(a)(3)? Which law determines whether a deposit is a deposit in the meaning of Rule 13k-1(a)(3): the law of the home country of the foreign bank or U.S. law (federal or state)? What is a substantial extent? Is "substantially" determined in absolute amounts or in relative amounts? If an absolute amount is determinative, small banks are disadvantaged. If it is a relative concept – what does it relate to? It could, for instance, relate to the balance sheet total or to liabilities or other balance sheet items? Why is it relevant that deposits are taken in the regular course of business? Is the taking of a few large deposits or of interbank deposits for funding purposes deposit-taking in the regular course of business?

Why is it relevant for purposes of Section 402 of the SO Act that the bank has the power to accept demand deposits? At any rate, how could a bank take deposits without that power? Does Rule 13k-1(a)(3)(ii) imply that a foreign bank must take time deposits (to a substantial extent) but need not actually take demand deposits as long as it has the power to do so?

Rule 13k-1(3)(iii) requires that the foreign bank extend commercial or other types of credit. Does "commercial or other types of credit" cover the universe of possible credit? If so, why does the Rule not simply require that the bank extends credit?

(c) The requirement and definition of being engaged substantially in the business of banking will create in many cases serious interpretative issues. Furthermore, this requirement has not been imposed by Section 402 of the SO Act on U.S. banks.

An insured depository institution under Section 3(c)(2) of the Federal Deposit Insurance Corporation Act ("FDIC Act"), 12 U.S.C. § 1813(c)(2), is not limited to institutions that take demand deposits and extend credit. *Depository institutions* is defined in Section 3(c)(1) of the FDIC Act, 12 U.S.C. § 1813(c)(1), as a bank or a savings association. A *bank* is defined in Section 3(a) of the FDIC Act, 12 U.S.C. § 1813(a), as a national bank or a State bank, a Federal branch and an insured branch. *State banks* must be in the business of receiving deposits, Section 3(a)(2)(A) of the FDIC Act, 12 U.S.C. § 1813(a)(2)(A), but the deposits need not be substantial, and a state bank need not be engaged in the extension of credit. **A** *national* ***bank*** is not at all defined in terms of deposit taking and extending credit although clearly national banks have the power to take deposits (see Eastern Townships Bank v. Vermont Nat'l Bank, 22 F.186 (Cir. Ct. D.Vt. 1884); see *also* 12 U.S.C. § 24, Seventh) and to make loans (see First Nat'l Bank v. Harris, 27 F.2d 117 (8th Cir. 1928)). Obviously, in most cases insured depository institutions under the FDIC Act presumably have deposits, but there is no such requirement and in particular

---

other foreign bank regulatory systems in which the deposit-taking power or activity of banks is not of relevance for the application of laws and regulations, see Gruson & Reisner, REGULATION OF FOREIGN **BANKS** – UNITED STATES AND **INTERNATIONAL** Vol. 2, 3d ed. 2000.

there is no requirement as to the size or nature of deposits or that deposits must be taken in the regular course of business. Certain special-purpose banks, such as those engaged solely in the business of issuing credit cards, have only one depositor solely for the purpose of qualifying for deposit insurance.

Bank, for purposes of the Bank Holding Company Act of 1956 ("BHC Act"), is defined as an insured bank as defined in Section 3(h) of the FDIC Act, 12 U.S.C. § 1813(h), or as an institution which both accepts demand deposits and is engaged in the business of making commercial loans. 12 U.S.C. § 1841(c)(1). However, the BHC Act does not address the supervision and regulation of banks as such and therefore its definition of bank should have no relevance for purposes of Rule 13k-1.

(d) Rule 13k-1(a)(iii) would require that the foreign bank must be engaged substantially in the business of banking. It is not clear what the word "substantially" is intended to express. Are only large banks covered? Does this word intend to distinguish between banking and nonbanking business? This could be very troublesome in countries in which banks are permitted to invest in nonbanking enterprises. Once a foreign bank is licensed and supervised as a bank in its home jurisdiction, it is neither appropriate nor useful to second-guess the foreign law and regulators by excluding from the definition foreign banks that under application of U.S. concepts of banking law are partially engaged in nonbanking activities.

(e) It seems to us that *foreign bank* should be defined as an institution:

(i) the home jurisdiction of which is other than the United States;

(ii) that is regulated as a bank in its home jurisdiction; and

(iii) that is engaged in the business of banking.

This definition would be very close to the definition of *bank* in Regulation K, 12 C.F.R. § 211.21(n), a result that makes sense because a proliferation of definitions of *foreign bank* is confusing.

2. Requirement of deposit insurance

Rule 13k-1(b)(1)(i) requires that the laws or regulations of the foreign bank's home jurisdiction require the bank to insure its deposits. We appreciate that this requirement is necessary in light of Section 402 of the SO Act. However, we propose not to use the term *deposit insurance.* This is a term of art of U.S. bank regulation, and thoughtful observers have convincingly argued that the U.S. deposit insurance is not insurance in any meaning of the term and that the term was chosen for purposes of political expediency. *See* Carter Golembe in Golembe Report No. 8 of 2000. European Union Directive 94/19/EC of the European Parliament and Council of 30 May 1994, O.J. Eur. Comm. No. L 135/5 (1994) very appropriately calls the directive a directive *on deposit-guarantee schemes.* Many deposit protection schemes of European countries are better described by that term. *See, e.g.*, Gruson, Banking Regulation in Germany, *supra*, § 8.17, discussing the German deposit protection

schemes. In order to avoid doubt and the need for unnecessary legal analysis, we propose to rephrase Rule 13k-1(b)(1) as follows:

> *(i)* *The laws or regulations of the foreign bank's home jurisdiction require the bank to insure its deposits or to be subject to a deposit-guarantee or protection scheme.*

It seems that a bank that under local law is permitted to voluntarily join a deposit insurance/deposit guarantee scheme should have the same benefit as a bank that is required to do so. The perceived advantages of the membership, namely increased supervision, apply equally in both cases.

The Release accompanying final Rule 13k-1 should recognize that countries have adopted a wide variety of deposit-guarantee or protection schemes and that it is not the intention of Rule 13k-1 to evaluate the merits and demerits of such schemes. For instance, German public sector banks (such as *Landesbanken*) and co-operative banks are exempted from the statutory deposit-guarantee scheme as long as they are members of a mutual deposit protection system that has the purpose of protecting the solvency and liquidity of the participating institutions rather than the protection of their customers. It stands to reason that the customer is better protected by a system that protects the solvency and liquidity of his bank rather than by a system that pays him a minimal amount in case of insolvency of the bank.

3. Comprehensive Supervision on a Consolidated Basis

Rule 13k-1(b)(1)(ii) requires a determination that the bank in question has been determined to be comprehensively supervised on a consolidated basis ("CSCB"). Under U.S. federal banking law, a finding of CSCB is required if a foreign bank wishes to establish an office in the United States, Section 7(d)(2)(A) of the International Banking Act of 1978, 12 U.S.C. § 3105(d)(2)(A) and 12 C.F.R. § 211.24(c)(1)(i)(A) (Regulation K), or where a foreign bank elects to be a financial holding company under Section 4(*l*)(1)(C) of the BHC Act, 12 U.S.C. § 1843(*l*)(1)(C) and 12 C.F.R. § 225.92(e) (Regulation Y), or where a foreign bank applies to become a bank holding company, Section 3(c)(3)(B), BHC Act, 12 U.S.C. § 1842(c)(3)(B) and 12 C.F.R. § 225.13(a)(4) (Regulation Y). In all these instances specific applications by specific foreign banks are required and it stands to reason that the applicant must demonstrate in this application that it is subject to CSCB. Rule 13k-1, however, deals with the general applicability to foreign banks of an exception from the prohibition of Section 402 of the SO Act and it does not seem appropriate to make the applicability of the exception dependent on whether a particular bank has in the past filed an individual application quite unrelated to the prohibition of Section 402 of the SO Act.

Furthermore, in our experience, it is highly unlikely that once the Board of Governors of the Federal Reserve System has determined the existence of CSCB in a country in connection with an individual application, it could reach a different result in connection with an application by another bank of the same country. CSCB requires an analysis of the banking law, regulations and administrative practices in a country and these do not change with respect to different banks, unless, of course, the second bank belongs to a different category of banks that is

subject to a different regulatory scheme, which is a determination that banking lawyers can readily make.

4. Alternative Reliance on Deposit Insurance and CSCB

We very much support the proposal to permit foreign banks to rely in the alternative on deposit insurance/guarantee schemes and comprehensive supervision on a consolidated basis. Section 402 of the SO Act mentions specifically insured banks. The rationale of this provision is not that the deposit insurance as such has any relevance to the soundness of loans to directors and officers. The rationale of Section 402 of the SO Act is that FDIC insurance provides a common set of prudential supervisory rules for substantially all banks in the United States. Section 402 of the SO Act refers to deposit insurance as a convenient reference to a common comprehensive supervisory system. Since the existence of a comprehensive system of supervision is the basis of the bank exception from the prohibition of Section 402 of the SO Act, it stands to reason that foreign banks that are subject (in the view of the Board of Governors) to a comprehensive system of supervision should be equally exempt from the prohibition of Section 402 of the SO Act. Consequently, it makes eminent sense and reflects the policy of Section 402 of the SO Act that Rule 13k-1 relies in the alternative on a home jurisdiction deposit insurance requirement ***or*** CSCB.

We do not support the sole reliance on CSCB. If, as Rule 13k-1 presently suggests, CSCB must have been found for the bank in question, the exemption from Section 402 of the SO Act would only apply to a relatively small group of foreign banks that have opened a branch or agency after 1991, the year in which the Foreign Bank Supervision Enhancement Act of 1991, Pub. L. No. 102-242, 102d Cong., 1st Sess. (Dec. 19, 1991), 105 Stat. 2286 (1991), introduced the CSCB requirement or that have acquired a U.S. bank after that date or have obtained financial holding company status (as of April 18, 2003, only 29 foreign banks have elected to be a financial holding company).

Even if, as proposed in this letter, the finding of CSCB for one bank of a country is sufficient to all banks subject to the same regulatory scheme from that country, sole reliance on CSCB would exclude banks from all countries whose banks have not (after 1991) entered the U.S. banking market by establishing a new office or bank subsidiary. This would create a distinction that is not based on a rationale that is relevant for Section 402 of the SO Act.

In our view, the proposal to rely on the foreign deposit protection ***or*** CSCB is sound. It would be very difficult for the SEC to establish detailed requirements which the foreign deposit protection scheme or foreign supervision must meet in order to give banks the benefit of an exemption from the prohibition of Section 402 of the SO Act. The SEC would have to embark on a qualitative evaluation of foreign bank regulatory systems.

5. Foreign Rules Comparable to Regulation O

Rule 13k-1(b)(2) proposes two conditions which insider loans must meet. It appears to us that these two conditions meet the rationale of Section 402 of the SO **Act.** To add a requirement that foreign insider lending restrictions must be substantially similar to Regulation

O, 12 C.F.R. § 215, seems to be an unnecessary and psychologically unwise imposition of U.S. regulations on foreign countries. The essential restrictions on insider lending are captured by Rule 13k-1(b)(2)(i) & (ii). What purpose would it serve to make foreign banks go through the very difficult analysis of comparing their rules with Regulation O and to reach the extremely difficult conclusion of "substantial similarity"? Few lawyers would be able to give an opinion that two pieces of legislation or regulation are "similar", in particular if the legislation or regulation is embedded in different legal systems.

As to the definition of parent, it appears sound to adopt the BHC Act approach of ownership of 25 percent of the voting securities, Section 2(a)(2) and (d), BHC Act, 12 U.S.C. § 1841(a)(2) and (d). First of all, Regulation O is based on that ownership percentage, 12 C.F.R. § 215.2(c), and it is difficult to justify a less favorable treatment for foreign bank holding companies. Foreign bank holding companies that control U.S. banks and foreign banks that are treated as bank holding companies because they operate a branch or agency in the United States, are familiar with the 25 percent threshold. A different threshold for purposes of insider loans would be confusing and appears not to be justified.

Once a foreign bank regulator has approved an insider loan, it would be seen as a violation of international comity if a U.S. regulator would second-guess the foreign bank regulator.

6. Interpretative Issue Regarding Schedule B Issuers

We would like to bring to your attention an interpretation issue under the Sarbanes-Oxley Act that is related to the matters covered by Rule 13k-1.

German state development banks are typically wholly or majority-owned by German state(s) they support, and their debt securities are guaranteed by such state(s). They, therefore, register their debt securities under Schedule B of the Securities Act of 1933, as amended (the "Securities Act"). As Schedule B filers, such banks are not subject to the reporting requirements of Section 15(d) of the Securities Exchange Act, which means that one of the alternative triggers of issuer status under Section 2(a)(7) of the SO Act, which is a requirement for the applicability of the insider lending prohibition of Section 13(k) of the Securities Exchange Act, is not met. Of course, state development banks may become subject to the insider lending prohibition if they list their debt securities on a U.S. national securities exchange, since issuer status under Section 2(a)(7) of the SO Act also applies to entities registered pursuant to Section 12 of the Securities Exchange Act. A development bank that issues securities under Schedule B but does not list the securities on a U.S. national securities exchange would under a literal reading of Section 2(a)(7) of the SO Act be an issuer and hence be subject to Section 13(k) of the Securities Exchange Act only for the brief period from the filing of the registration statement until effectiveness.[3] After effectiveness, it would cease to be an *issuer* and cease to be subject to Section 13(k) of the Securities Exchange Act. This interpretative issue is further discussed in the memorandum attached to this letter as Exhibit A.

---

[3] Pursuant *to* Section 2(a)(7) of the SO Act, an issuer includes an issuer "that files or has filed a registration statement that has not yet become effective".

This result, of course, makes no sense and cannot have been intended by Congress. We respectfully request that the release accompanying the final Rule 13k-1 set forth an explanation that this result is not intended.

If you have any questions regarding this letter, please feel free to contact Michael Gruson, Tel. (212) 848-8060, e-mail: mgruson@sheannan.com.

Very truly yours,

Shearman & Sterling LLP

SHEARMAN & STERLING LLP

Memorandum on the Application of Section 13(k) of the Securities Exchange Act of 1934 to Schedule B Issuers

The insider lending prohibition, like most other provisions of the Sarbanes-Oxley Act of 2002 ("SO Act"), applies to "issuers" within the meaning of Section 2(a)(7) of the SO Act. Section 2(a)(7) of the SO Act provides that the term "issuer" means an issuer (as defined in Section 3 of the Securities Exchange Act of 1934 ("Securities Exchange Act")):

- the securities of which are registered under Section 12 of the Securities Exchange Act;
- that is required to file reports under Section 15(d) of the Securities Exchange Act; or
- that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933, as amended (the "Securities Act"), and that has not been withdrawn.

This "issuer" definition leads to the absurd result that the insider lending prohibition under Section 13(k) of the Securities Exchange Act technically applies to foreign governments and certain other entities eligible to register securities under Schedule B of the Securities Act (collectively referred to herein as "Schedule B Issuers"),[1] which are generally not subject to the reporting requirements of Section 15(d) of the Securities Exchange Act, on a temporary basis each time they file a registration statement under the Securities Act until such registration statement is declared effective.[2]

We believe that Congress did not intend such a temporary applicability of the insider lending prohibition to Schedule B Issuers.

---

1 Without specifically deciding whether various entities are a "foreign government or political subdivision thereof" within the meaning of Section 7(a) of the Securities Act, in several no-action letters, the Securities and Exchange Commission has advised issuers who were not sovereign states, but who, to varying degrees, were owned and/or controlled by a foreign government and whose securities were guaranteed or supported by foreign sovereign credit, that they may register their securities using Schedule B (see, *e.g.*, Bank of Greece, SEC No-Action Letter (June 2, 1993); Kreditanstalt fur Wiederaufbau (SEC No-Action Letter (September 21, 1987); Nordiska Investerings Banken, SEC No-Action Letter (February 1, 1982)).

2 The insider lending prohibition's applicability would not be limited to the period between the filing and effectiveness of a Securities Act registration statement if the Schedule B Issuer listed its securities on a U.S. national securities exchange, which would require the registration of such securities under Section 12 of the Securities Exchange Act. While we believe that the applicability of the insider lending prohibition to Schedule B Issuers was not intended by the SO Act at all and raises serious comity issues, we limit our further discussion in this memorandum to cases where a Schedule B Issuer does not, and is not required to, register its securities under Section 12 of the Securities Exchange Act.

protection of investors.[4] Since Schedule B Issuers would be deemed to be "issuers" under Section 2(a)(7) of the SO Act only prior to the effective date of their registration statement, that is before any securities covered by the registration statement could have been publicly sold in the United States, Schedule B Issuers would be subject to the insider lending prohibition at a time when investors do not hold any stake in them. On the other hand, absent the filing of additional registration statements, the Schedule B Issuer would not be subject to any restrictions (other than home country law) on the granting of personal loans during the entire term of the securities issued.

Shearman & Sterling LLP

---

4 *See* the SO Act's title: "An Act to Protect Investors by Improving the Accuracy and Reliability of Corporate Disclosures Made Pursuant to the Securities Laws..."