

ACT 40
SECTION _____
RULE 3a-6
PUBLIC
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April 21, 1998
Our Ref. No. 98-147
Safra Republic Holdings, S.A.
File No. 812-7184

**RESPONSE OF THE OFFICE OF CHIEF COUNSEL
DIVISION OF INVESTMENT MANAGEMENT**

Your letter of April 20, 1998 requests our concurrence that certain wholly owned subsidiaries of Safra Republic Holdings, S.A. ("Safra") are foreign banks for purposes of Rule 3a-6 under the Investment Company Act of 1940 and may rely on the exclusion from the definition of investment company provided by that rule.

Facts

You state that Safra is organized and regulated as a bank holding company under the laws of Luxembourg. In addition, because Republic National Bank of New York ("RNBNY"), a U.S. bank, owns approximately 49 percent of Safra's outstanding equity shares, Safra also is subject to U.S. banking regulations with respect to capital adequacy and lending limits, limitations on transactions with its affiliates, and certain reporting requirements concerning itself and its subsidiaries.

You state that Safra provides international commercial banking services to high net worth individuals, partnerships, and closely held corporations through wholly owned banking subsidiaries located in Switzerland, Luxembourg, France, Monaco, and Guernsey (collectively, "Banking Subsidiaries"). You state that the principal business of the Banking Subsidiaries is to accept deposits, the vast majority of which are time deposits with terms of six months or less. You state that deposits represent at least 90 percent of each Banking Subsidiary's liabilities.¹ You also state that the primary lending activity of the Banking Subsidiaries is to provide credit to other banks through interbank deposits, with such deposits ranging from 53 percent to 84 percent of each Banking Subsidiary's total assets. You explain that interbank deposits are a form of commercial lending between banks, and that a bank wishing to make an interbank deposit typically will evaluate the other bank in much the same way as it evaluates loan counterparties. The amount of conventional loans underwritten by each Banking Subsidiary ranges from 2 percent to 14 percent of total assets.²

¹You state that, as of June 30, 1997, the percentage of liabilities represented by deposits for each Banking Subsidiary is as follows: RNBNY (Switzerland) -- 90%; RNBNY (Luxembourg) -- 93%; RNBNY (France) -- 94%; RNBNY (Monaco) -- 96%; and RNBNY (Guernsey) -- 93%.

²You state that, as of June 30, 1997, for each Banking Subsidiary the percentage of assets represented by interbank deposits and conventional loans, respectively, is as follows: RNBNY (Switzerland) -- 59% and 12%; RNBNY (Luxembourg) -- 53% and 14%; RNBNY (France) -- 58% and 14%; RNBNY (Monaco) -- 69% and 2%; and RNBNY (Guernsey) -- 84% and 2%.

You state that Safra would like to sponsor American Depository Receipts ("ADRs") for its common stock that would be listed for trading on a securities exchange in the United States. Because Safra holds securities issued by the Banking Subsidiaries, Safra's issuance of the ADRs would raise issues under the Investment Company Act.

Analysis

Section 3(a)(1)(C) of the Investment Company Act defines the term "investment company" as any issuer that is engaged or proposes to engage in the business of investing, reinvesting, owning, holding or trading in securities, and owns or proposes to acquire investment securities having a value exceeding 40 percent of the issuer's total assets (exclusive of Government securities and cash items) on an unconsolidated basis. Section 3(a)(2) of that Act defines the term "investment securities" for purposes of this section to include all securities except (A) Government securities, (B) securities issued by employees' securities companies, and (C) securities issued by majority owned subsidiaries which (i) are not investment companies and (ii) are not relying on the exclusions from the definition of investment company in Sections 3(c)(1) or 3(c)(7) of the Act.

Rule 3a-6 excludes from the definition of investment company under the Investment Company Act any foreign bank that meets the rule's requirements.³ The rule defines a foreign bank as a banking institution incorporated or organized under the laws of a country other than the United States, or a political subdivision of a country other than the United States, that is (A) regulated as a banking institution by that country's or subdivision's government or any agency of that government, (B) engaged substantially in commercial banking activity, and (C) not operated for the purpose of evading the provisions of the Investment Company Act.

If each of the Banking Subsidiaries meets the definition of foreign bank in Rule 3a-6, then each Banking Subsidiary would be excepted from the definition of investment company. The securities issued by the Banking Subsidiaries that are held by Safra would not be considered "investment securities" within the meaning of Section 3(a)(2) because the Banking Subsidiaries are wholly owned subsidiaries that are not investment companies and are not relying on the exclusions from the definition of investment company in Sections 3(c)(1) or

³Although Section 3(c)(3) of the Investment Company Act excludes "banks" from the definition of investment company, the Banking Subsidiaries may not rely on that exception because the definition of "bank" in Section 2(a)(5) of that Act does not include foreign banks.

3(c)(7). Thus, these securities would not be counted when determining whether Safra falls within the definition of investment company set forth in Section 3(a)(1)(C).⁴

You believe that each Banking Subsidiary meets the definition of foreign bank in Rule 3a-6. You represent that each Banking Subsidiary is organized or incorporated as a banking institution in the country in which it operates, and that each Banking Subsidiary is regulated as a commercial bank by the government of that country.⁵ You also represent that no Banking Subsidiary is being operated for the purpose of evading the Investment Company Act.

You ask for our concurrence that each Banking Subsidiary is "engaged substantially in commercial banking activity," which Rule 3a-6 defines to mean "engaged regularly in, and deriving a substantial portion of its business from, extending commercial and other types of credit, and accepting demand and other types of deposits, that are customary for commercial banks in the country in which the head office of the banking institution is located." You believe that each Banking Subsidiary meets this requirement so long as time deposits are considered to be "other types of deposits" and interbank deposits are considered to be extensions of "commercial and other types of credit." You maintain that time deposits should be considered to be "other types of deposits" because time deposits are considered to be "deposits" by the banking regulators in the countries in which the Banking Subsidiaries operate and under U.S. law.⁶ You also contend that interbank deposits should be considered to be an extension of "commercial and other types of credit" because they are considered to be extensions of credit by the banking regulators in the countries in which the Banking Subsidiaries operate and under U.S. law.⁷ Finally, you state that accepting time deposits

⁴You state that you are not asking for the staff's position on whether Safra falls within the definition of investment company set forth in Section 3(a)(1)(C). Therefore, we take no position on this matter.

⁵You note, however, that RBNBY (Monaco), like other banks that operate in Monaco, is supervised by French banking regulators in accordance with the Franco-Monegasque Conventions. You represent that, under Monegasque law, banks operating in Monaco must comply with French banking regulations. You therefore maintain that RBNBY (Monaco) is regulated as a banking institution by Monaco's government for purposes of Rule 3a-6. We agree that RBNBY (Monaco) is regulated in Monaco as a banking institution "by that country's or subdivision's government or any agency" of that government for purposes of Rule 3a-6.

⁶For example, Section 3 of the Federal Deposit Insurance Act specifically includes "time deposits" as a type of deposit for purposes of that Act. See 12 U.S.C. § 1813(l)(l).

⁷For example, Section 23(a) of the Federal Reserve Act, which authorizes the Federal Reserve Board to regulate the "exposure" of one bank to another bank in order to limit the risks of bank failures on other banks, defines the term "exposure" to include "all extensions

and making interbank deposits are customary banking activities in the countries in which the Banking Subsidiaries operate and in the United States.

Rule 3a-6 is intended to put foreign banks that sell securities in the United States on an equal footing under the Investment Company Act with domestic banks that sell securities in the United States without registering as investment companies in reliance on Section 3(c)(3) of that Act.⁸ On the basis of your representations that (1) time deposits are considered to be deposits, and interbank deposits are considered to be extensions of credit, both by the banking regulators in the countries in which the Banking Subsidiaries operate and under U.S. law, and (2) accepting time deposits and making interbank deposits are customary banking activities in the countries in which the Banking Subsidiaries operate and in the United States, we agree that time deposits and interbank deposits can be considered to be deposits and extensions of credit, respectively, for purposes of Rule 3a-6.

Based on the facts and representations set forth in your letter, we agree that each Banking Subsidiary is "engaged substantially in commercial banking activity."⁹ We therefore agree that the Banking Subsidiaries are foreign banks for purposes of Rule 3a-6 and may rely on the exception from the definition of investment company provided by that rule. Because this response is based on the facts and representations in your letter, you should note that any different facts or representations might lead to a different conclusion.


 Rochelle Kauffman Plesset
 Senior Counsel

of credit to the other depository institution, regardless of name or description, including . . . all deposits at the other depository institution." 12 U.S.C. § 371b-2(c)(1)(A)(i). In addition, the Office of the Comptroller of the Currency takes the position that a deposit made by a bank in an affiliated bank would be considered a loan or extension of credit to the affiliate for purposes of Section 23A of the Federal Reserve Act, which sets forth restrictions on transactions with affiliates. *See Extensions of Credit to Insiders and Transactions with Affiliates (Interpretative Appendix) (Oct. 2, 1996), 61 FR 54533, 54536 (Oct. 21, 1996).*

⁸*See Exception From the Definition of Investment Company for Foreign Banks and Foreign Insurance Companies, Investment Company Act Release No. 18381 (Oct. 29, 1991), 56 F.R. 56294 (Nov. 4, 1991) (adopting Rule 3a-6). See also supra note 3.*

⁹In this regard, we agree that each Banking Subsidiary currently meets the "engaged substantially" requirement of the rule. *See supra* notes 1-2 and accompanying text.

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April 20, 1998

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Subject: Exemption of a Foreign Bank Sponsoring ADRs from the Provisions of
the Investment Company Act of 1940

We are writing on behalf of Safra Republic Holdings, S.A. ("SRH") concerning its proposed sponsorship of American Depository Receipts ("ADRs") for its common stock. The ADRs would be issued pursuant to an exemption from registration under the Securities Act of 1933 and would be listed for trading on an American securities exchange. SRH is organized under the laws of Luxembourg as a bank holding company, and is supervised as such by the Institut Monétaire Luxembourgeois ("IML"). Among other services, SRH provides international commercial banking services to high net worth individuals, partnerships, and closely held corporations through wholly owned banking subsidiaries located in Switzerland, Luxembourg, France, Monaco, and Guernsey (collectively, the "Banking Subsidiaries"). Each of these Banking Subsidiaries is licensed and regulated as a commercial bank in its country of operation and is organized or incorporated under the law of its country of operation.

We are writing to request that the staff of the Division of Investment Management concur with our view that each of these Banking Subsidiaries is "engaged substantially in commercial banking," for the purposes of Rule 3a-6 under the Investment Company Act of 1940. As a result, the securities issued by the Banking Subsidiaries and held by SRH would not be "investment securities" within the meaning of Section 3(a)(2) of the Act and as applied in determining whether SRH falls within the definition of "investment company" set forth in Section 3(a)(1)(C). We are not asking for the staff's guidance on whether SRH falls within the definition set forth in Section 3(a)(1)(C).

BACKGROUND

A. History of Safra Republic Holdings, S.A.

SRH was formed in the late 1980's to acquire the European banking subsidiaries of Republic National Bank of New York, a U.S. bank organized under the National Bank Act^{1/} ("Republic National Bank"). Republic National Bank initially owned 100% of the equity of SRH. In 1988, SRH publicly offered additional shares in Europe and conducted a private placement in the United States. As a result of this offering, Republic National Bank owns approximately 49% of the outstanding common stock of SRH. Approximately 30% of the outstanding common stock is held by public investors, principally outside of the United States. The public holders of SRH's common stock include 16 institutions and five individuals who are United States persons. The remaining 21% is held by a private investor, who is also the principal shareholder of Republic National Bank. SRH's common stock is listed on the Swiss Electronic Stock Exchange, the Luxembourg Stock Exchange and is traded over-the-counter in London on SEAQ (Stock Exchange Automated Quotation system).

B. Banking Regulation and Banking Activities of SRH

1. Banking Regulation of SRH

Because Republic National Bank owns more than 25% of SRH's common stock, SRH is regulated on a consolidated basis in accordance with United States banking law and the principles set forth by the Basle Committee in the "Concordat." Under commitments made to the Federal Reserve Board, Republic National Bank and SRH are subject to quantitative and qualitative limitations on transactions with affiliates. Further, SRH is subject to United States regulations on capital adequacy and lending limits. SRH is subject to supervision by the Federal Reserve Board and the Office of the Comptroller of the Currency. It is required to provide United States bank regulators with periodic financial and management reports concerning itself and each of the Banking Subsidiaries.

SRH is also subject to a comprehensive regulatory regime as a Luxembourg bank holding company. IML regulations^{2/} applicable to SRH and its Banking Subsidiary in Luxembourg concern, among other things, solvency ratios, limitations on lending, and customer identification and protection of bank secrecy. SRH must file audited year-end consolidated financial statements and audited financial statements of each subsidiary in addition to quarterly consolidated reports including a statement of condition, solvency ratio,

^{1/} 12 U.S.C. §1, *et seq.*

^{2/} Pursuant to Luxembourg law, IML and the Minister of the Treasury issue banking regulations based on EU Directives which govern reporting requirements, supervision on a consolidated basis, credit loss provisioning and off-balance sheet items.

profit and loss account, and concentration of risks. The IML and its representatives have an unrestricted right to examine the books and records of SRH. SRH is not regulated by the IML as an investment company. As more fully discussed below, each of SRH's Banking Subsidiaries is subject to extensive banking regulation in its country of origin. None of the Banking Subsidiaries is regulated as investment companies.

2. Banking Activities of SRH and the Banking Subsidiaries

Through its wholly-owned Banking Subsidiaries, SRH provides international commercial banking services to over 22,000 high net worth individuals, partnerships, and closely held corporations from over 80 countries. The principal activity of SRH's Banking Subsidiaries is gathering deposits. The Banking Subsidiaries traditionally have placed principal emphasis on safety, soundness, and liquidity of deposits. As of June 30, 1997, SRH had over 22,000 deposit customers representing \$14.9 billion^{3/} in deposits. Deposits are accepted at each of the Banking Subsidiaries; the majority are placed with the Banking Subsidiaries in Switzerland, Luxembourg and France. Rates of interest paid on deposit accounts are governed by local bank regulations. As of June 30, 1997, \$2.012 billion of SRH's deposits had a maturity of one month or less and \$10.95 billion had maturities of one to three months. Depositors include high net worth individuals and some governmental and quasi-governmental organizations. Client deposits equaled 72.6% of SRH's total liabilities on June 30, 1997. Deposits from banks and other financial institutions accounted for an additional 12.8% of SRH's total liabilities.

In addition to accepting deposits, SRH's Banking Subsidiaries offer comprehensive banking services, of which loans to customers is a significant component. As of June 30, 1997, SRH's total loans, net of unearned income, equaled \$1.995 billion, or 10.8% of its total assets. SRH's lending activities include margin loans, extensions of credit in connection with import and export financing, issuing and confirming letters of credits, issuing guarantees and granting loans to banks, governments, governmental agencies, companies and individuals.^{4/}

SRH's primary lending activity is the extension of credit to other banks through interbank deposits, which SRH regards as a very conservative form of commercial lending. Funds advanced to other banks are deposited in accounts in the name of the Banking Subsidiaries at the other banks. Interbank deposits allow the Banking Subsidiaries to ensure liquidity, reduce credit risk and match the maturity and interest rate characteristics of their deposit liabilities. For the six months ended June 30, 1997, interbank deposits of \$6.65

^{3/} Unless otherwise noted, all monetary amounts discussed in this memorandum are denominated in United States dollars.

^{4/} SRH generally avoids making unsecured loans and has strict limits on loan size regardless of collateralization.

billion (35.9% of total assets) produced \$169 million in interest income, 32.7% of SRH's total gross interest income.

In addition to interest income from extensions of credit through lending activity and interbank deposits, SRH derives revenue from debt securities, as well as from foreign exchange, off-balance sheet financial instruments, and other trading assets. SRH's income from debt instruments is principally derived from U.S. Government debt instruments and debt instruments issued by OECD-member countries.^{5/} For the six months ended June 30, 1997, these instruments generated 56.4% of SRH's total gross interest income and their holdings accounted for 50.3% of its total assets on June 30, 1997.^{6/}

Through non-banking subsidiaries SRH also offers investment funds and provides trust services. These services do not account for a significant portion of SRH's revenues. For the six months ended June 30, 1997, the funds generated \$10.12 million in fee income to SRH, which equaled 1.7% of SRH's gross income.

C. Banking Regulation and Banking Activities of the Banking Subsidiaries

1. Republic National Bank of New York (Suisse)

Republic National Bank of New York (Suisse) (hereinafter, "RNBNY(Suisse)"), SRH's Banking Subsidiary located in Switzerland, is subject to Switzerland's Banking Law and its Implementing Ordinance. The primary objective of the Banking Law is the protection of depositors. RNBNY(Suisse) is regulated by the Federal Banking Commission and the Swiss National Bank. Under the supervision of these banking regulators, RNBNY(Suisse) is subject to regulations and restrictions governing capital adequacy, maintenance of reserve requirements, extensions of credit, savings deposits and customer protection, reporting and auditing, and prevention of illegal money laundering, among other subjects. As of June 30, 1997, deposits totaled 90% of RNBNY(Suisse)'s liabilities. Seventy-one percent of RNBNY(Suisse)'s assets were related to extensions of credit, with conventional loans

^{5/} On June 30, 1997, SRH owned U.S. Government and agency securities worth \$4.87 billion, which equaled 54.6% of its \$8.92 billion portfolio. Another 8.8% consisted of OECD government and agency securities and 10% consisted of Non-OECD governmental securities. SRH also purchases corporate bonds guaranteed by companies in the U.S. and other jurisdictions, primarily OECD member countries, and bond guarantees issued by international banks.

^{6/} SRH offers other services tailored to the needs of private banking clients. It provides portfolio management services (over 90% on a non-discretionary basis) and the execution of transactions in foreign exchange, precious metals, securities and banknotes. It also provides safekeeping, trust and other fiduciary services. As of June 30, 1997, client portfolio management assets exceeded \$15 billion.

comprising 12% of its assets, and interbank deposits accounting for another 59%.

2. Republic National Bank of New York (Luxembourg)

Like SRH, Republic National Bank of New York (Luxembourg) (hereinafter, "RNBNY(Luxembourg)") is subject to banking regulation by the IML. As noted above, applicable IML regulations concern, among other things, solvency ratios, limitations on lending, and customer identification and protection of bank secrecy. While the IML also supervises investment companies, RNBNY(Luxembourg) is regulated as a bank, rather than an investment company. As of June 30, 1997, deposits totaled 93% of RNBNY(Luxembourg)'s liabilities. Sixty-seven percent of RNBNY(Luxembourg)'s assets were related to extensions of credit, with conventional loans comprising 14% of its assets, and interbank deposits accounting for another 53%.

3. Republic National Bank of New York (France)

Republic National Bank of New York (France) (hereinafter, "RNBNY(France)") is subject to the Law 84-46 of January 24, 1984 and regulated by the Comité de la Réglementation Bancaire, the Comité des Etablissements de Crédit and the Commission Bancaire.⁷¹ As a French bank, RNBNY(France) is subject to regulations and requirements relating to minimum capital requirements, operating standards, accounting and reporting requirements, prudential ratios, and credit operations. As of June 30, 1997, deposits totaled 94% of RNBNY(France)'s liabilities. Seventy-two percent of RNBNY(France)'s assets were related to extensions of credit, with conventional loans comprising 14% of its assets, and interbank deposits accounting for another 58%.

4. Republic National Bank of New York (Monaco)

In addition to being subject to the French banking regulators described above, Republic National Bank of New York (Monaco) (hereinafter, "RNBNY(Monaco)") must file annual reports with the Budget and Treasury Department of the Monegasque government. As of June 30, 1997, 96% of RNBNY(Monaco)'s liabilities consisted of deposits. Seventy-one percent of RNBNY(Monaco)'s assets were related to extensions of credit, with conventional loans comprising 2% of its assets, and interbank deposits accounting for another 69%.

5. Republic National Bank of New York (Guernsey)

⁷¹ Significantly, RNBNY(France) is not regulated by the Commission des Opérations de Bourse, the primary regulator of collective investment schemes (known as organismes de placement collectif en valeurs mobilières) in France.

Republic National Bank of New York (Guernsey) (hereinafter, "RNBNY(Guernsey)") is regulated by the Guernsey Financial Services Commissions ("GFSC") and the Banking Supervision Law 1994, which is modeled on the United Kingdom Banking Act 1987. The primary purpose of the Banking Supervision Law is the protection of depositors, and the GFSC has endorsed the views of the Basle Committee. Principal regulations involve capital adequacy requirements and the filing of audited annual accounts. As of June 30, 1997, deposits totaled 93% of RNBNY(Guernsey)'s liabilities. Conventional lending activities comprised 2% of its assets, while interbank deposits accounted for another 84% for a total commitment of 86% of RNBNY(Guernsey)'s total assets to the extension of credit.

DISCUSSION

A. The Investment Company Act

The Investment Company Act is the principal statute by which investment companies in the United States are regulated. The analysis of whether an entity is subject to the Act begins with section 3(a), which contains two broad *prima facie* definitions of "investment company": section 3(a)(1)(A) and section 3(a)(1)(C).^{8/} Section 3(a)(1)(C) of the Investment Company Act provides a definition of investment company that is intended to cover so-called "inadvertent investment companies." Section 3(a)(1)(C) applies to issuers that: (1) are engaged in the business (whether or not primarily); (2) of investing, reinvesting, owning, holding, or trading in securities; and (3) that own or propose to acquire "investment securities" having a value exceeding 40 per cent of the issuer's total assets (exclusive of Government securities and cash items) on an unconsolidated basis. As applicable, "investment securities" include all securities other than Government securities and securities issued by majority-owned subsidiaries that are not, themselves, investment companies.

In the context of foreign banks, Rule 3a-6 under the Investment Company Act provides that a "foreign bank," even if it might otherwise fit within the statutory definition of "investment company," is not an "investment company for purposes of the Act." For purposes relevant here, Rule 3a-6(b)(1)(I) defines a "foreign bank" to mean a banking

^{8/} Section 3(a)(1)(B) encompasses a largely extinct type of issuer conducting business relating to "face-amount certificates of the installment type" and is not relevant to this memorandum. In the context of holding companies such as SRH, the Commission has recognized that such companies typically do not fall within the section 3(a)(1)(A) definition of investment company. *United Asset Management Corp.*, SEC No-Action Letter, 1981 WL 26656 (Nov. 2, 1981); *accord, e.g., Centex Corporation*, SEC No-Action Letter, 1986 WL 67464 (Nov. 20, 1986).

institution^{9/} incorporated or organized under the laws of a country other than the United States that is:

- (A) Regulated as such by that country's government or any agency thereof;
- (B) Engaged substantially in commercial banking activity; and
- (C) Not operated for the purpose of evading the provisions of the Company Act.

The Commission has specifically contemplated that holding companies of foreign banks excluded by rule 3a-6 generally can rely on the asset test in section 3(a)(1)(C) to determine their status under the Investment Company Act -- and ordinarily would not fall within the definition in section 3(a)(1)(A).^{10/}

B. Application of the Investment Company Act to SRH and the Banking Subsidiaries

In our view, the Banking Subsidiaries are excepted from the definition of investment company by Rule 3a-6. As noted above, each SRH's Bank Subsidiaries is regulated by the government in the country in which it operates as a commercial bank.^{11/} None of the Banking Subsidiaries is regulated as an investment bank or investment company. The Banking Subsidiaries have not been operated for the purpose of evading the provisions of the Investment Company Act. Each has been operating its banking businesses in foreign countries for years. The only issue, then, is whether the Bank Subsidiaries can be said to be

^{9/} Although "banks" are excepted from the definition of investment company by Section 3(c)(3) of the Company Act, neither SRH nor its subsidiaries is a "bank" for purposes of Section 3(c)(3) because the term is limited by Section 2(a)(5) to entities that are organized under the laws of the United States, members of the Federal Reserve System, or that, among other things, do business under the laws of any state or the United States.

^{10/} *Exception From the Definition of Investment Company for Foreign Banks and Foreign Insurance Companies*, Investment Company Act Release No. 18381 (Nov. 4, 1991).

^{11/} Rule 3a-6(B)(1)(i)(A) specifies that a "foreign bank" is one organized under the laws of a foreign country and regulated as such by "that country's or subdivision's government or any agency thereof." (Emphasis added.) As noted, RBNBY Monaco is regulated by French banking authorities. The regulation of Monégasque banks by French banking authorities results from the Franco-Monégasque Conventions, which are agreements between the two countries. Under Monégasque law, Monégasque banks are required to comply with French banking regulations. Accordingly, RBNBY Monaco is regulated as a bank by Monaco's government within the meaning of Rule 3a-6.

“engaged substantially in commercial banking.”^{12/}

The term "engaged substantially in commercial banking activity" is defined by Rule 3a-6(b)(2) to mean:

engaged regularly in, and deriving a substantial portion of its business from, extending commercial and other types of credit, and accepting demand and other types of deposits, that are customary for commercial banks in the country in which the head office of the banking institution is located.

While "substantial" as used in Rule 3a-6 is not defined, it plainly means something less than "principal" or "primary." Rule 3a-6 is descended, largely without change, from former Commission Rule 6c-9. As originally proposed in 1986, Rule 6c-9 would have defined "foreign bank" as an entity "primarily engaged in accepting demand deposits and making commercial loans."^{13/}

In response to criticism by commenters that this definition was too restrictive, the Commission determined to revise the definition "so that it imposes no requirements as to the primary activities engaged in by the entity seeking to use the rule."^{14/} The Commission also broadened the definition of "engaged substantially in commercial banking activity" to include the acceptance of "demand and other" deposits and the extension of "commercial and other" credit. The Commission gave no explanation for this latter change.

In 1991, the Commission rescinded Rule 6c-9 and promulgated Rule 3a-6. This rule carried forward most of the substance of the earlier rule and permitted foreign banks to issue equity as well as debt securities in reliance on the rule. The Commission made no change to

^{12/} When a holding company owns securities issued by non-investment company subsidiaries, the staff of the Commission has stated that "it appears that [the holding company] would not be an investment company as defined in section 3(a)(1) because its primary business would be owning or holding securities rather than 'investing, reinvesting, or trading' in them, compare [sic] 'investing, reinvesting, owning, holding or trading' in Section 3(a)(3)...." *United Asset Management Corp.*, SEC No-Action Letter, 1981 WL 26656 (Nov. 2, 1981); *accord, e.g., Centex Corporation*, SEC No-Action Letter, 1986 WL 67464 (Nov. 20, 1986).

^{13/} See *Exemption From the Investment Company Act of 1940 for the Offer or Sale of Debt Securities and Non-Voting Preferred Stock by Foreign Banks or Foreign Bank Holding Companies*, Investment Company Act Release No. 16093 (Oct. 29, 1987) ("*Rule 6c-9 Adopting Release*") (emphasis added).

^{14/} *Id.*

the definition of “engaged substantially in commercial banking activity.” The Commission reaffirmed that the overarching purpose of the rule was

to put foreign banks selling securities in the United States on an equal footing under the Act with banks in like circumstances organized under the laws of the United States.^{15/}

1. SRH’s Banking Subsidiaries Are “Engaged In the Business of Commercial Banking”

a. SRH’s Banking Subsidiaries Derive A Substantial Amount of Their Business From Accepting Demand and Other Deposits

The principal business of SRH’s Banking Subsidiaries is to accept demand and other deposits. Relatively few of these deposits are demand deposits, although the vast majority are for 6 months or less. Both the demand and time deposits are plainly “deposits” within the meaning of Rule 3a-6. Rule 3a-6 describes involvement in “commercial banking activity” as including the acceptance of “demand and other deposits.” The demand deposits accepted by the Banking Subsidiaries are explicitly covered by the rule.

The time deposits are “other deposits” within the meaning of the rule. They are funds deposited by customers with the Banking Subsidiaries for specified terms and at rates of interest agreed to between them and the Banking Subsidiaries. Accepting time deposits is a customary banking activity in each of the countries in which the Banking Subsidiaries operate and in the United States. While the funds are on deposit, the Banking Subsidiaries maintain accounts showing the amounts owed to each customer. Pursuant to the agreements, at the end of the specified term the Banking Subsidiaries are obligated to return the funds to the clients plus the interest.

^{15/} *Id.* In the release proposing amendments to Rule 6c-9, the Commission also stated it wanted to expand the rule to exempt entities that do not, in effect, function as investment companies and are already regulated by an appropriate regulatory authority. *Exemption from the Investment Company Act of 1940 for the Offer and Sale of Securities by Foreign Banks*, Investment Company Act Release No. 17682 (Aug. 17, 1990). The Commission further noted that the expansion was designed to cover entities with which it was already familiar through the exemptive process. The Commission recognized, however, that different countries have different regulatory schemes and definitions of the range of permitted bank activities. In the subsequent release adopting Rule 3a-6 in place of the proposed amendments to Rule 6c-9, the Commission expressed reluctance to exempt foreign financial institutions which were sufficiently dissimilar to the primarily commercial banks with which it was familiar without the further analysis provided by exemptive applications. *Adopting Release* at * 4 & n.15.

The liabilities consisting of the obligations to pay the funds to the clients at the expiration of the designated term are carried on the financial statements of the Banking Subsidiaries as "deposits." These financial statements are certified by independent auditors and are submitted to the banking authorities in the countries in which the Banking Subsidiaries are located. The time deposits are thus customarily viewed as "deposits" by the regulatory authorities in the countries in which the Banking Subsidiaries are located.

These liabilities are also recognized as "deposits" by banking regulators in the United States. "Deposit" has an extremely broad definition under United States banking law. Under the Federal Deposit Insurance Act, "deposit" is defined to include virtually any liability for money owed by a bank to a person. See 12 U.S.C. § 1813 (a)(1), which sets forth the applicable definition. The Federal Reserve Board, in Regulation D of its regulations, defines "deposit" in equally sweeping terms. See 12 C.F.R. § 204.2(a)(1).

Each of the Banking Subsidiaries carried deposits equal to at least 90% of its liabilities as of June 30, 1997. Specifically, the percentage of liabilities represented by deposits are as follows: RBNBY(Suisse)--90%; RBNBY(Luxembourg)--93%; RBNBY(France)--94%; RBNBY(Monaco)--96%; and RBNBY(Guernsey)--93%.^{16/} Clearly, SRH's Banking Subsidiaries derive a substantial amount of business from accepting demand and other deposits.

b. SRH's Banking Subsidiaries Derive a Substantial Amount of Their Business From Extending Commercial And Other Types of Credit

Because of SRH's conservative approach in regard to risk, a high percentage of the assets of the Banking Subsidiaries are interbank deposits as opposed to other types of commercial loans. As noted earlier, for the six months ended June 30, 1997, at least two-thirds of the assets of each Banking Subsidiary consist of extensions of credit in the form of loans and interbank deposits. Specifically, the percentage of assets represented by conventional lending activities and interbank deposits are as follows: RBNBY(Suisse)--71%; RBNBY(Luxembourg)--67%; RBNBY(France)--72%; RBNBY(Monaco)--71%; and RBNBY(Guernsey)--86%. If interbank deposits are considered under Rule 3a-6 as an "other type" of credit, each of the Banking Subsidiaries can plainly be said to be "deriving a substantial portion of its business from, extending commercial and other types of credit."^{17/}

^{16/} On a consolidated basis, SRH held \$12.24 billion in deposits as of June 30, 1997. These constituted 72.6% of SRH's total liabilities.

^{17/} On a consolidated basis, SRH's assets include \$1.995 billion in loans, which constitute 10.8% of its total assets. Most of these loans are with SRH's individual customers. These, of course, are no less "commercial" than loans to non-natural persons.

By definition, only banks make interbank deposits. In economic reality, interbank deposits are merely specialized forms of extensions of credit to the accepting banks and are indistinguishable from other forms of lending. And in fact, from a risk management standpoint, the Banking Subsidiaries treat interbank deposits just as they do other forms of extension of credit. As a matter of general practice, commercial banks, including the Banking Subsidiaries, evaluate the banks with which they place deposits in much the same way they evaluate loan counterparties. Interbank deposits are managed by each Banking Subsidiary's treasurer within established guidelines set by SRH that take into account credit risks, maturity and currency risks. Making interbank deposits is a customary banking activity in each of the countries in which the Banking Subsidiaries operate and in the United States. Interbank deposits are regarded as extensions of credit by the banking regulators of the countries in which the Banking Subsidiaries operate.

United States banking law treats interbank deposits as extensions of credit. To take a recent example, in 1991 Congress made a variety of changes to the banking laws through the enactment of the Federal Deposit Insurance Corporation Improvement Act, 105 Stat. 2236 (1991). Section 308(a) of that statute added a new Section 23(a) to the Federal Reserve Act, 12 U.S.C. § 221 et seq. That provision, codified at 12 U.S.C. § 371b-2, was designed to minimize the risk of snowballing bank failures by granting to the Federal Reserve Board broad authority to regulate the "exposure" of one bank to another. Significantly, Congress defined "exposure" to include three classes of transactions, one of which is --

"all extensions of credit to the other depository institution, regardless of name or description, including . . . all deposits at the other depository institution." 12 U.S.C. 371b-2(c)(1)(A)(i)(emphasis added).^{18/}

The legislative history of the provision confirms that Congress intended, in the words of the Senate Banking Committee, to minimize the risk arising when banks "extend credit representing significant portions of their capital to one another."^{19/}

Similarly, Section 23A of the Federal Reserve Act, 12 U.S.C. § 371c, governs transactions that constitute a "loan or extension of credit" between affiliated banks and grants the Office of the Comptroller of the Currency to regulate those transactions. In 1996, the OCC promulgated new rules to cover affiliated transactions. In an interpretative appendix to the rules, the OCC specifically found that "[t]he OCC considers a deposit made by a bank in

^{18/} Notably, holdings of securities of other banks formed a discrete category of exposure, rather than being considered an extension of credit. *Id.* at §371b-2(c)(1)(B) and (C).

^{19/} S. Rep. No. 167, 102nd Cong., 1st Sess., at 118.

an affiliated bank to be a loan or extension of credit under " 12 U.S.C. 371c.^{20/}

Most recently, the Internal Revenue Service re-proposed rules that would treat interbank deposits as loans for purposes of a lending test used to determine whether a foreign corporation's income is derived from the active business of banking or from the kinds of passive investments made by investment funds.^{21/} Prior to 1986, U.S. investors in foreign investment companies were not taxed on undistributed income retained by a foreign investment company. In contrast, investors in domestic investment companies generally were taxed on all of the fund's income, distributed or not. Congress decided to eliminate this tax advantage of investing in foreign funds by enacting the Passive Foreign Investment Company ("PFIC") Rules.^{22/} These rules apply to shareholders of a foreign corporation if at least 75% of the corporation's income is passive or at least 50% of its assets produce passive income. For the purposes of applying these tests, Congress specified that income derived from the active conduct of a banking business by a United States licensed bank would not constitute passive income.

The IRS has subsequently provided guidance and proposed regulations that provide similar treatment for foreign banks that are not licensed in the United States.^{23/} Among other requirements, to qualify as "foreign banks," entities must accept a substantial amount of deposits and "regularly make loans to customers in the ordinary course of its trade or business."^{24/} These requirements are driven by the IRS' belief that Congress intended that the banking exception should apply "only to corporations that conform to a traditional U.S. banking model."^{25/} Significantly, the IRS's recent proposal specifically concludes that "the IRS and Treasury determined that interbank deposits were made and accepted in the ordinary course of a banking business, and therefore should be treated as such for purposes" of the

^{20/} See, e.g., *Extensions of Credit to Insiders and Transactions With Affiliates*, 61 F.R. 54533, 54536 (OCC Oct. 21, 1996).

^{21/} General Rules for Making and Maintaining Qualified Electing Fund Elections, IRS Notice of Proposed Rulemaking, 63 F.R. 39 (Jan. 2, 1998). The proposed rules are attached.

^{22/} See *id.*; *Exceptions to Passive Income Characterization for Certain Foreign Banks and Securities Dealers*, IRS Notice of Proposed Rulemaking, 60 F.R. 20922 (Apr. 28, 1995).

^{23/} *Id.*

^{24/} *Exceptions to Passive Income Characterization for Certain Foreign Banks and Securities Dealers*, IRS Notice of Proposed Rulemaking, 60 F.R. 20922 (Apr. 28, 1995).

^{25/} *Id.*

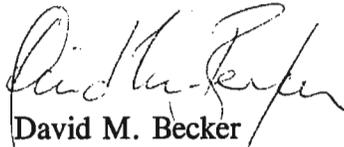
Internal Revenue Code.^{26/}

In sum, while interpreting an exception analogous to the bank exception in the Investment Company Act, the IRS has come to the conclusion that interbank deposits should be considered loans for purposes of distinguishing foreign banks from foreign corporations that are essentially investment companies. Similarly, interbank deposits should be considered extensions of "commercial and other types of credit" for purposes of Rule 3a-6.

* * * * *

Based on the foregoing, we respectfully request that the Staff concur with our view that each of these Banking Subsidiaries is "engaged substantially in commercial banking," for the purposes of Rule 3a-6 under the Investment Company Act and is thus excepted from the definition of "investment company."

Sincerely,



David M. Becker
Marianne K. Smythe
Janet M. Grossnickle

^{26/}

63 F.R. at 39.