

## CORPORATE GOVERNANCE ALERT

### SEC ADOPTS FOREIGN BANK EXEMPTION FROM THE INSIDER LENDING PROHIBITION OF EXCHANGE ACT SECTION 13(K)



On April 27, 2004, the Securities and Exchange Commission (SEC) published final rules providing qualified foreign banks with an exemption from the insider lending prohibition under Section 402 of the Sarbanes-Oxley Act (the Act), codified as Section 13(k) of the Securities Exchange Act of 1934 (the 1934 Act). Section 402 prevents most public companies from extending credit to directors and executive officers. Intuitively, institutions such as banks or their holding companies that make loans in the ordinary course of business should have an exemption under the Act if their directors and executive officers are not afforded any special treatment during the loan application process. The Act does in fact provide an exemption for lenders whose deposits are insured by the Federal Deposit Insurance Corporation (FDIC) and comply with other regulatory requirements. But because many foreign banks are ineligible for FDIC insurance, they cannot avail themselves of the statutory exemption. The SEC has adopted Rule 13k-1 under the 1934 Act to provide relief to these kinds of foreign banks that meet the eligibility criteria detailed below.

#### THE REGULATORY PROBLEM

Section 402 of the Act prohibits any issuer from directly or indirectly extending or maintaining credit, arranging for the extension of credit, or renewing an extension of credit “in the form of a personal loan” to or for any of its directors or executive officers. The Act does not distinguish between U.S. and non-U.S. companies. To provide some relief from the Section 402 prohibition to issuers that ordinarily engage in the business of making loans, the Act provides a number of exemptions, including an exemption to any loan extended by an insured bank or savings association that has insured its deposits with the FDIC, if the loan is subject to the insider lending restrictions of Section 22(h) of the Federal Reserve Act.

A foreign bank is generally not eligible for U.S. deposit insurance and, with the exception of a few grandfathered institutions, can only qualify deposit accounts for FDIC insurance by holding them through a subsidiary formed under U.S. state or federal law. Nevertheless,

many foreign banks are already subject to home-country supervision of insider loans and are otherwise eligible for deposit insurance or guarantees in their home countries. Because foreign banks cannot avail themselves of the statutory exception, the Act therefore places many foreign banks whose securities are registered under the Securities Act of 1933 (the 1933 Act) or the 1934 Act at a distinct disadvantage relative to their counterparts chartered under U.S. state or federal law.

### **THE NEW EXEMPTION**

To address this regulatory discrepancy, and in the interest of international comity, the SEC has adopted an exemption from Section 402 for foreign banks through the introduction of Rule 13k-1 under the 1934 Act. Rule 13k-1 provides that an issuer that is a foreign bank (or the parent or other affiliate of a foreign bank) is exempt from the Section 402 insider loan prohibition with respect to any loan made by the foreign bank so long as either:

- the laws or regulations of the foreign bank's home jurisdiction require the bank to insure its deposits or be subject to a similar deposit guarantee or protection scheme, or
- the Federal Reserve Board has determined that the foreign bank or another bank organized in the foreign bank's home jurisdiction is subject to comprehensive supervision or regulation on a consolidated basis by the bank supervisor in its home jurisdiction.

Furthermore, the loan by the foreign bank to any of its directors or executive officers or those of its parent or other affiliate must:

- be on substantially the same terms as those prevailing at the time for comparable transactions by the foreign bank with other persons who are not executive officers, directors or employees of the foreign bank, its parent or other affiliate
- be under a benefit or compensation program that is widely available to the employees of the foreign bank, its parent or other affiliate that does not give preference to any of the executive officers or directors of the foreign bank, its parent or other affiliate over any other employees of the foreign bank, its parent or other affiliate, or
- have received express approval by the bank supervisor in the foreign bank's home jurisdiction.

### **DEFINITIONS**

As used in Rule 13k-1, "foreign bank" means an institution, the home jurisdiction of which is other than the United States, that is regulated as a bank in its home jurisdiction and engages directly in the business of banking. Notably, under the 1934 Act, the United States includes the District of Columbia, Puerto Rico, the U.S. Virgin Islands and any other possession of the United States.

"Home jurisdiction" means the country, political subdivision or other place in which a foreign bank is incorporated or organized.

“Engages directly in the business of banking” means that an institution engages directly in banking activities that are usual for the business of banking in its home jurisdiction.

“Affiliate,” “parent” and “subsidiary” have the same meaning as under Rule 12b-2 of the 1934 Act.

The explanatory notes to Rule 13k-1 also provide that “issuer” does not include a foreign government, as defined under Rule 405 of the 1933 Act, that files a registration statement under the 1933 Act on Schedule B. The SEC adopted this exclusion to clarify that Section 402’s insider lending prohibition does not apply to Schedule B filers. This exclusion is consistent with other provisions of the Act for which the SEC has likewise exempted foreign governments in the interest of international comity.

### **REVISION TO FORM 20-F**

The SEC has also expanded the list of reportable related-party transactions under Item 7.B.2 of Form 20-F. Specifically, if a registrant, its parent or any of its subsidiaries is a foreign bank that made an exempt loan under Rule 13k-1, it must identify the director, senior management member or other related party required to be described who received the loan, and it must describe the nature of the loan recipient’s relationship to the foreign bank. In response to the concern that foreign privacy laws may prohibit this kind of disclosure, the SEC will permit a registrant to not make a specific disclosure if the registrant determines that such disclosure would conflict with the privacy laws, such as customer confidentiality and data protection laws, of its home jurisdiction. A registrant seeking to avail itself of this exemption must provide a legal opinion attesting to that conclusion as an exhibit. In addition, where foreign privacy laws prohibit specific disclosure, the registrant must nonetheless disclose in the Form 20-F that:

- an unnamed director, senior management member or other related party for which disclosure is required has been the recipient of a loan under Rule 13k-1
- the privacy laws of the registrant’s home jurisdiction prevent the disclosure of the name of the loan recipient, and
- the loan recipient is unable to waive or has otherwise not waived application of these privacy laws.

### **EFFECTIVE DATE**

Rule 13k-1 became effective on April 30, 2004, and the new disclosure item on Form 20-F becomes effective on June 1, 2004.

## CONTACT INFORMATION

If you have any questions or would like to learn more about this topic, please contact the partner who normally represents you or:

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