

MEMO# 22660

July 8, 2008

SEC Proposes to Modify Rules Allowing Foreign Broker-Dealers to Access U.S. Investors

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TO: SEC RULES COMMITTEE No. 44-08
EQUITY MARKETS ADVISORY COMMITTEE No. 28-08
INTERNATIONAL COMMITTEE No. 16-08 RE: SEC PROPOSES TO MODIFY RULES ALLOWING
FOREIGN BROKER-DEALERS TO ACCESS U.S. INVESTORS

The Securities and Exchange Commission recently proposed to amend Rule 15a-6 under the Securities Exchange Act of 1934 to expand the scope of conditional exemptions from broker-dealer registration for foreign entities and to ease or eliminate some of the existing restrictions on interactions between foreign broker-dealers and U.S. customers. [\[1\]](#)

Comments on the proposed amendments are due to the SEC by September 8, 2008. We will hold a conference call on Thursday, July 17, at 2:00 p.m. Eastern time to discuss the Institute's comments relating to the SEC's proposal. The dial-in number for the conference call will be 1-800-593-0578 and the passcode for the call will be 60224. If you plan to participate on the call, please contact Jennifer Odom by email at jodom@ici.org or by phone at 202-326-5833.

Rule 15a-6 currently permits non-U.S. broker-dealers to have certain limited contacts with U.S. investors without registering with the SEC. [\[2\]](#) The proposal would expand the category of U.S. investors that foreign broker-dealers may contact for the purpose of providing research reports and soliciting securities transactions, as well as reduce the role U.S. registered broker-dealers must play in intermediating transactions effected by foreign broker-dealers on behalf of certain U.S. investors. If adopted, the

proposal would supersede and supplant all prior no-action letter guidance issued in connection with Rule 15a-6.

Extension of Rule 15a-6 to Qualified Investors

The proposal would expand the categories of U.S. investors with which a foreign broker-dealer could interact by replacing the current categories of “major U.S. institutional investor” and “U.S. institutional investor” with the category of “qualified investor,” as defined in Section 3(a)(54) of the Exchange Act. The category of “qualified investor” would include institutional investors or natural persons who own or invest on a discretionary basis at least \$25 million in assets. The proposal explains that some persons that are currently included in the categories of U.S. investors with which a foreign broker-dealer may interact would be excluded from the scope of “qualified investor” because of inadequate investment experience.

Unsolicited Trades

The proposal would provide further interpretive guidance related to solicited securities transactions under the proposed rule with respect to quotation systems. Currently, the SEC takes the position that a solicitation has not occurred for purposes of Rule 15a-6 where there is a U.S. distribution of foreign broker-dealers’ quotations by third-party systems, such as systems operated by foreign marketplaces or by private vendors, that distribute the quotations primarily in foreign countries and that do not allow securities transactions to be executed between foreign broker-dealers and persons in the United States. Under the proposal, the SEC would eliminate the condition that the quotations be distributed primarily in foreign countries, so that U.S. distribution of foreign broker-dealers’ quotations by a third-party system, that does not provide execution capability, would not be viewed as a form of solicitation in the absence of other contacts with U.S. investors initiated by the third-party system or the foreign broker-dealer.

Provision of Research Reports

The proposal would expand the class of investors to which a foreign broker-dealer could distribute research reports to, and effect transactions in the securities discussed in the research reports with, “qualified investors” in substitution for “major U.S. institutional investors.” It would not modify the conditions of the current exemption permitting distribution of research reports by foreign broker-dealers. For example, the research reports could not recommend the use of the foreign broker-dealer to effect trades in any security and the foreign broker-dealer could not provide research to U.S. persons pursuant to any express or implied understanding that those U.S. persons will direct commission income to the foreign broker-dealer.

Solicited Trades

The proposal would significantly revise the conditions under which a foreign

broker-dealer could induce or attempt to induce the purchase or sale of a security by certain U.S. investors by requiring the foreign broker-dealer to engage a U.S. registered broker-dealer under one of two exemptive approaches. Exemption (A)(1) could only be used by foreign broker-dealers that conduct a “foreign business,” while Exemption (A)(2) could be used by all foreign broker-dealers.

Exemption (A)(1)

Under the proposal, a foreign broker-dealer would be able to effect transactions and custody funds and securities for “qualified investors” provided a number of conditions are satisfied. First, a U.S. registered broker-dealer would be required to maintain the books and records for any transactions effected by a foreign broker-dealer. The records could be maintained in the form, manner, and for the periods prescribed by the foreign securities authority regulating the foreign broker-dealer. A U.S. registered broker-dealer also could maintain such books and records with the foreign broker-dealer provided the U.S. broker-dealer makes a reasonable determination that copies of the books and records could be (and are) furnished promptly to the SEC upon request.

The proposal would eliminate many of the requirements currently imposed on the intermediating U.S. registered broker-dealer. For example, the U.S. registered broker-dealer would no longer be required to extend or arrange for the extension of credit, issue confirmations and account statements, receive, deliver and safeguard funds and securities in connection with the SEC’s Customer Protection Rule, or maintain accounts for the customers of foreign broker-dealers relying on the proposed Exemption (A)(1). A U.S. registered broker-dealer would, however, have to be involved in effecting any transactions on a U.S. securities exchange or alternative trading system, or with a U.S. market maker or over-the-counter dealer.

Second, the foreign broker-dealer would have to be regulated by a “foreign securities authority” meaning a foreign government, governmental body, or regulator given authority by a foreign government to enforce that country’s securities laws.

Third, the foreign broker-dealer would be required to disclose that it is not regulated by the SEC and that U.S. segregation requirements, bankruptcy protections, and protections under Securities Investor Protection Act (“SIPA”) would not apply to any funds and securities of the “qualified investors” held by the foreign broker-dealer.

Fourth, the broker-dealer would have to conduct a “foreign business,” meaning that at least 85 percent of the aggregate value of the securities bought and sold by U.S. investors or foreign residents in the U.S. from the foreign broker-dealer, as calculated on a rolling two-year basis, would be derived from transactions in foreign securities. As proposed, foreign securities would include debt and equity securities of foreign private issuers, debt securities of issuers organized or incorporated in the United States but where

the distribution is wholly outside the United States, and certain securities issued by foreign governments. [\[3\]](#)

Exemption (A)(2)

Under the proposal, a foreign broker-dealer would be able to effect transactions for “qualified investors” that custody their funds and securities with a U.S. registered broker-dealer provided a number of conditions are satisfied. First, a U.S. registered broker-dealer would be responsible for maintaining the books and records for any transactions effected by the foreign broker-dealer. The U.S. registered broker-dealer also would be required to receive, deliver, and safeguard funds and securities for the transactions effected by the foreign broker-dealer in compliance with the SEC’s Customer Protection Rule. In addition, a U.S. registered broker-dealer would have to be involved in effecting any transactions on a U.S. securities exchange or alternative trading system, or with a U.S. market maker or over-the-counter dealer.

Second, like proposed Exemption (A)(1), the foreign broker-dealer would have to be regulated by a foreign securities authority to qualify for proposed Exemption (A)(2).

Third, the foreign broker-dealer would have to disclose that it is not regulated by the SEC, but it would not have to provide disclosures to the “qualified investor” regarding segregation requirements, bankruptcy protections, and protections under SIPA.

Additional Requirements

The proposal would eliminate the “chaperoning” requirements that (1) foreign associated persons be accompanied by an associated person of a U.S. registered broker-dealer during in-person visits with U.S. investors and (2) an associated person of a U.S. registered broker-dealer participate in communications (whether oral or electronic) between foreign associated persons and U.S. investors. The proposal would retain some restrictions on direct contact between a foreign broker-dealer and a U.S. investor by defining a “visit” for purposes of the proposed rule as one or more trips to the United States over a calendar year that do not last more than 180 days in the aggregate.

The proposal would require foreign broker-dealers to meet certain qualification requirements. It would retain the current requirement that a foreign broker-dealer provide the SEC, upon request or pursuant to agreement between the SEC or the United States and any foreign securities authority, information or documents related to the foreign broker-dealer’s activities in inducing or attempting to induce securities transactions by “qualified investors.” The proposal also would require the foreign broker-dealer to determine that its associated persons who effect transactions with “qualified investors” are not subject to a statutory disqualification. The proposal would set forth the specific information that the foreign broker-dealer would have to maintain in its files and make available upon request.

A U.S. registered broker-dealer would have to obtain a representation from the foreign broker-dealer that it has made the requisite determination regarding its associated persons, it is maintaining the required information, and it will make the information available upon request by the U.S. registered broker-dealer or the SEC.

Counterparties and Specific Customers

Under the proposal, a foreign broker-dealer that conducts a “foreign business” would be permitted to solicit and effect transactions involving “foreign resident clients.” This would be a new category of permissible “counterparties and specific customers” as listed in Rule 15a-6. A “foreign resident client” would be defined as: (1) an entity not organized in the U.S. or engaged in a trade or business under U.S. tax laws; (2) a natural person who is not a U.S. resident under U.S. tax laws; or (3) an entity not organized in the U.S. and is at least 85 percent owned by an entity or person that meets either of the first two definitions of a “foreign resident client.” Such transactions would be undertaken between the foreign broker-dealer and a U.S. resident fiduciary of accounts for the “foreign resident clients.” A U.S. resident fiduciary would be considered to be a U.S. person, regardless of the residence of the owners of the underlying accounts. To use the exemption, the proposal would require a foreign broker-dealer to obtain a written representation from the U.S. fiduciary that the account is managed in a fiduciary capacity for a “foreign resident client.”

Familiarization with Foreign Options Exchanges

Under the proposal, a foreign broker-dealer would be permitted to effect transactions involving options on foreign securities on the foreign options exchange of which it is a member for a “qualified investor” if the foreign broker-dealer did not solicit the investor. The proposal also would permit certain activities by a foreign options exchange representative or foreign office, which would include providing “qualified investors” with a disclosure document that describes the foreign options exchange and, upon request by the investor, providing a list of participants that can take orders for that exchange.

Scope of the Proposed Exemption

Under the proposal, the SEC would extend the formal exemptive relief under Rule 15a-6 to the registration requirement and the reporting and other applicable requirements of the Exchange Act, and the rules thereunder, that apply to a broker-dealer solely by virtue of its status as a broker or dealer rather than because of its registration with the SEC. The proposal would not extend exemptive relief to the requirements under Sections 15(b)(4) and 15(b)(6), which give the SEC the authority to sanction broker-dealers and persons associated with broker-dealers for misconduct.

Commission Comment

The Commission seeks comment on all aspects of the proposal. In particular, it

seeks comment on:

- whether it is appropriate to substitute “qualified investor” for the former categories of investors that foreign broker-dealers may contact without registering as U.S. broker-dealers;
- whether there are categories of investors included in the proposed use of the definition of “qualified investor” that should be excluded, such as market intermediaries exempt under Section 3(c)(2) of the Investment Company Act, or categories of investors that should be excluded;
- whether additional guidance is needed under its interpretation of solicitation for other entities, such as third-party or proprietary systems that provide indications of interest;
- whether, under proposed Exemption (A)(1), the applicable dispute resolution system should be disclosed, the 85 percent threshold for “foreign business” is appropriate, and the definition of foreign broker-dealer is appropriate;
- whether, under proposed Exemption (A)(2), the requirements imposed on U.S. registered broker-dealers should differ based on whether the securities are U.S. securities or foreign securities;
- whether unchaperoned contacts between foreign broker-dealers and their associated persons and “qualified investors” are appropriate;
- whether the Commission should require a foreign broker-dealer or a representative of a foreign options exchange to determine that the persons with whom the representative communicates or otherwise provides information are, in fact, “qualified investors;” and
- whether it would be necessary or appropriate in the public interest, and be consistent with the protection of investors, to exempt foreign broker-dealers from requirements other than the registration requirements.

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endnotes

[1] See Exemption of Certain Foreign Brokers or Dealers, SEC Release No. 34-58047 (June 27, 2008), 73 FR 39181 (July 8, 2008). The proposal is available on the SEC’s website at: <http://www.sec.gov/rules/proposed/2008/34-58047.pdf>.

[2] Under Rule 15a-6, foreign broker-dealers may engage in: (1) “nondirect” contacts by foreign broker-dealers with U.S. investors through execution of unsolicited securities transactions and the provision of research reports to certain U.S. institutional investors and (2) “direct” contacts, involving the execution of transactions through a registered broker-dealer intermediary with or for certain U.S. institutional investors and without this intermediary with or for certain entities such as registered broker-dealers and banks acting in a broker or dealer capacity.

[3] This definition also would include derivative instruments on debt and equity securities of foreign private issuers. It would not include derivative instruments that are not themselves securities.

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