

COMMENT LETTER

September 11, 2008

ICI Comment Letter on SEC Proposal to Modify Rules Allowing Foreign Broker-Dealers to Access U.S. Investors (pdf)

September 8, 2008 Ms. Florence Harmon Acting Secretary U.S. Securities and Exchange Commission 100 F Street, N.E. Washington, D.C. 20549-1090 Re: Exemption of Certain Foreign Brokers or Dealers (File No. S7-16-08) Dear Ms. Harmon: The Investment Company Institute¹ supports the goal of the Commission's proposal to expand the category of U.S. investors that would have greater access to foreign broker-dealers and foreign securities markets.² By liberalizing the restrictions on access to foreign markets, the proposal should significantly enhance the ability of U.S. investors to access more directly the securities of foreign issuers in a manner that may reduce costs for institutional investors seeking to trade foreign securities. Investment companies are the primary means for small U.S. investors to access foreign markets, providing an efficient and economical means of gaining exposure to foreign securities. As U.S. investor demand for foreign stocks and bonds has increased, funds are playing an increasingly important role in the trading on these markets. As of July 2008, total net assets of international and global equity and bond mutual funds were approximately \$1.7 trillion.³ In 2007 alone, U.S. residents purchased \$252 billion in foreign stocks and bonds, and mutual funds and exchange-traded funds accounted for a substantial amount of those purchases.⁴ Given the increasing importance of the means by which funds

¹ The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of \$12.14 trillion and serve almost 90 million shareholders.

² Exemption of Certain Foreign Brokers or Dealers, SEC Release No. 34-58047 (June 27, 2008), 73 FR 39181 (July 8, 2008).

³ Investment Company Institute, Monthly Trends Report, July 2008.

⁴ Of the \$252 billion invested in foreign stocks and bonds, mutual funds and ETFs accounted for \$194 billion and \$49 billion respectively. See 2008 Investment Company Fact Book, 48th Edition, p. 12.

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trade in the global markets, we commend the Commission for taking steps to modernize its rules and regulations to better reflect the current environment for trading in those markets and, at the same time, to ensure that sufficient investor protections remain in place in connection with the expansion of foreign broker-dealer access to U.S. investors. Proposals to Reform Rule 15a-6 Rule 15a-6 under the Securities Exchange Act of 1934, as amended ("Exchange Act") currently permits non-U.S. broker-dealers to have certain limited contacts with U.S. investors without registering

with the Commission.⁵ The proposed amendments would expand and streamline the ability of U.S. investors to access the services of foreign broker-dealers without triggering the Commission's broker-dealer registration, reporting, and other requirements. Expansion of the Scope of Rule 15a-6 to "Qualified Investor" The proposal would expand the category of U.S. investors that foreign broker-dealers can provide research to, and solicit trades from, by replacing the current categories of "major U.S. institutional investor" and "U.S. institutional investor" with the category of "qualified investor," as currently defined under Section 3(a)(54) of the Exchange Act. The most significant result of this change is the reduction (or, in some cases, the elimination) of the threshold value of assets or investments owned or invested that is required under the rule.⁶ The Institute supports expanding the scope of the rule in this manner. Most significantly, the proposal would expand the investment and diversification opportunities for U.S. investors, may lower the costs of accessing such opportunities and would make these benefits available to more U.S. investors. We also agree with the Commission that a "qualified investor" should possess the necessary investment experience to effect transactions with foreign broker-dealers under the proposal. Easing U.S. Broker-Dealer Intermediation Requirements The proposal would reduce the role that a registered U.S. broker-dealer must perform in intermediating transactions between a foreign broker-dealer and a qualified investor, shifting many of 5 Under Rule 15a-6, foreign broker-dealers may engage in: (1) "nondirect" contacts 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. 6 Under the proposal, the threshold would decline from institutional investors that own or control greater than \$100 million in total assets to, among others, all investment companies registered with the Commission under Section 8 of the Investment Company Act of 1940 and corporations, companies, or partnerships that own or invest on a discretionary basis \$25 million or more in investments. Ms. Florence Harmon September 8, 2008 Page 3 of 4 the existing obligations to the foreign broker-dealer. Most significantly, the proposed amendments would establish two alternative exemptions for foreign broker-dealers to satisfy the intermediation requirements when soliciting qualified investors.⁷ In addition, U.S. broker-dealers would no longer have to "chaperone" certain in-person visits and oral communications between foreign associated persons and U.S. institutional investors. The Institute supports the proposed amendments to ease the intermediation requirements of Rule 15a-6. Allowing a foreign broker-dealer to hold in-person meetings and to conduct oral and electronic communications with qualified investors without the intermediation of a U.S. registered broker-dealer would facilitate more efficient communications between qualified investors and foreign broker-dealers and would remove impractical requirements and unnecessary burdens on U.S. broker-dealers. Maintain Adequate Investor Protections We support expanding and streamlining the conditions of Rule 15a-6. The Commission's approach to modernizing the rule is a step in the right direction in responding to the internationalization of the securities markets. At the same time, however, the Commission must ensure that sufficient safeguards remain in place in connection with the expansion of foreign broker-dealer access to U.S. investors. The proposal takes several steps in this regard although, as discussed more fully below, we believe the Commission should clarify the applicability of an additional important safeguard. Significantly, we support the proposed requirement under the rule that a foreign broker-dealer be regulated in a foreign country by a foreign securities authority for the specific securities activities in which the foreign broker-dealer engages with qualified investors. We agree with the Commission that this requirement would ensure that only foreign entities that are legitimately engaged in

the securities business and that are regulated in the conduct of those activities may rely on the exemptions for solicited trades in paragraph (a)(3) of Rule 15a-6. We note that qualified investors also will be protected under the rule by the prohibition on contact from foreign associated persons that are subject to statutory disqualifications. Further, we support the proposed disclosure requirements that are intended to ensure that investors are aware that their transactions with foreign broker-dealers are not subject to the full scope of the Commission's broker-dealer regulatory framework and protections. We agree with the Commission's assessment that such disclosures will be important because of the elimination of the chaperoning requirements and the more limited participation in transactions by a U.S. registered broker-dealer. 7 Specifically, if 85 percent of a foreign broker-dealer's business is in foreign securities (the "foreign business test"), then the foreign broker-dealer can custody securities and conduct all aspects of a transaction except that a U.S. broker-dealer must be responsible for maintaining copies of books and records of the transactions with U.S. qualified investors. Alternatively, if a foreign broker-dealer does not meet the foreign business test, then the foreign broker-dealer can effect the transaction but a U.S. broker-dealer must maintain the books and records and custody the customer funds and securities. Ms. Florence Harmon September 8, 2008 Page 4 of 4 In addition to adopting these important investor protections, however, we believe the Commission should make clear that foreign broker-dealers relying on the new exemptions in proposed paragraph (a)(3) are subject to the anti-fraud provisions of the U.S. securities laws with regard to their contacts with U.S. investors. Such protections are critical, given the limited (if any) role of a U.S. broker-dealer in these contacts.⁸ Finally, we recommend that the Commission monitor the implementation of the rule to ensure that it provides the necessary safeguards for investors and examine whether further investor protections are warranted. * * * * * We look forward to working with the Commission as it continues to examine these critical issues. In the meantime, if you have any questions, please feel free to contact me directly at (202) 371- 5408 or Heather Traeger at (202) 326-5920. Sincerely, /s/ Ari Burstein Ari Burstein Senior Counsel cc: The Honorable Christopher Cox, Chairman The Honorable Kathleen L. Casey The Honorable Elisse B. Walter The Honorable Troy A. Paredes The Honorable Luis A. Aguilar Erik Sirri, Director Robert L.D. Colby, Deputy Director Daniel Gallagher, Deputy Director Brian A. Bussey, Assistant Chief Counsel, Office of the Chief Counsel Division of Trading and Markets 8 We also recommend that the Commission confirm our understanding that the proposal would not create any new requirements for qualified investors, such as requirements relating to monitoring foreign broker-dealers for their compliance with the provisions of the rule or any recordkeeping or disclosure requirements.

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