PROPOSED AMENDMENTS TO RULE 15A-6 UNDER THE SECURITIES EXCHANGE ACT OF 1934 EXEMPTING CERTAIN FOREIGN BROKER-DEALERS FROM U.S. REGISTRATION REQUIREMENTS

On June 27, 2008, the Securities and Exchange Commission ("SEC") proposed significant amendments to Rule 15a-6 under the Securities Exchange Act of 1934 ("Exchange Act"), which provides exemptions from broker-dealer registration for foreign entities engaged in certain activities in the United States.[1] The amendments would generally expand the category of U.S. investors that foreign broker-dealers may contact for the purpose of providing research reports and soliciting securities transactions, and would also reduce the role U.S. registered broker-dealers must play in intermediating or "chaperoning" transactions effected by foreign broker-dealers on behalf of certain U.S. investors. The comment period on the proposed amendments closes on September 8, 2008.

Current Rule 15a-6:

The SEC uses a territorial approach in applying the broker-dealer registration requirements to the international operations of broker-dealers, so broker-dealers located outside the United States that induce or attempt to induce securities transactions with persons in the United States are required to register with the SEC, unless an exemption applies.

In 1989, the SEC adopted Rule 15a-6 under the Exchange Act to exempt from registration foreign broker-dealers that conduct certain limited activities in the United States.[2] A precondition to the exemption under Rule 15a-6 is that the foreign broker-dealer not have any office or personnel in the United States. Rule 15a-6 contains four separate exemptions, set forth in paragraphs (a)(1) through (a)(4) of the rule.

- Paragraph (a)(1) currently exempts unsolicited transactions in which the U.S. investor initiates the order to buy or sell entirely of its own accord without prompting by the foreign firm. The SEC adopts a broad view of the concept of solicitation that makes the paragraph (a)(1) exemption of little practical use.

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1 Exemption of Certain Foreign Brokers or Dealers, Exchange Act Release No. 34-58047, 73 Fed. Reg. 39182 (July 8, 2008); http://www.sec.gov/rules/proposed/2008/34-58047.pdf.

2 The scope of the rule has been modified through no-action letters issued by the SEC staff, *e.g.*, Letter re: Transactions in Foreign Securities by Foreign Broker or Dealers with Accounts of Foreign Persons (Nov. 22, 1995, revised Jan. 30,1996) (the "Seven Firms Letter"); Letter re: Securities Activities of U.S.-Affiliated Foreign Dealers (Apr. 9, 1997). In a number of respects, the proposed amendments are codifications of these modifications.

- Paragraph (a)(2) exempts transactions with *major U.S. institutional investors*, a term defined in Rule 15a-6,[3] who have been provided with research reports prepared and disseminated in compliance with Rule 15a-6. A foreign broker or dealer relying on this exemption may not initiate follow-up contacts with U.S. investors, except in compliance with subsection (a)(3) of the Rule.
- The paragraph (a)(3) exemption permits foreign broker-dealers to conduct business with "U.S. institutional or major U.S. institutional investors," terms defined in paragraph (b) of the rule, as long as an SEC-registered broker-dealer is actively involved in any transactions conducted under paragraph (a)(3), including (i) effecting any such transactions, (ii) maintaining custody of customer funds and securities, and (iii) "chaperoning" the activities of the foreign broker-dealer's representatives or associated persons with the U.S. institutional investors and major U.S. institutional investors. *Individuals* are neither U.S. institutional investors nor major U.S. institutional investors under Rule 15a-6.
- The paragraph (a)(4) exemption permits securities transactions effected from abroad by a foreign broker-dealer with or for, among others, an SEC-registered broker-dealer or a bank acting for its own account or for the account of its customers, as well as certain supra-national entities such as the World Bank. The SEC interprets this provision as prohibiting direct contact between the foreign broker or dealer and the customers of the SEC-registered broker-dealer.

The Proposed Amendments:

Expanded List of Potential Customers

The proposed amendments to Rule 15a-6 generally would broaden the category of U.S. investors that a foreign broker-dealer[4] could solicit without registration with the SEC by replacing the categories of U.S. institutional investor and major U.S. institutional investor with "qualified investor," as defined in Exchange Act Section 3(a)(54). The term "qualified investor" includes registered investment companies, banks and broker-dealers, among others. It also includes corporations, partnerships, companies and natural persons who own and invest, on a

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[3] Current Rule 15a-6 defines "U.S. institutional investor" and "major U.S. institutional investor." The distinction between the two is primarily that "major U.S. institutional investors" have, or have under management, total assets in excess of $100 million.

[4] The term "foreign broker or dealer" means any non-U.S. resident person (including any U.S. person engaged in business as a broker or dealer entirely outside the U.S., except as otherwise permitted), that is not a branch of, or a natural person associated with, a registered broker or dealer, whose activities, if conducted in the U.S., would be those of a broker or dealer as defined in the Exchange Act. The proposed definition would be the same as the current rule except for a requirement that the foreign broker-dealer be subject to regulation by a foreign securities authority under proposed paragraph (a)(3) and a foreign business requirement for proposed paragraphs (a)(3)(A)(1) and (a)(4)(vi) discussed below. *See* proposed Rule 15a-6(b)(2).

discretionary basis, at least $25 million in investments, as well as a governmental or political subdivision, agency or instrumentality of a government that owns and invests on a discretionary basis not less than $50 million in investments.[5] The SEC states that, given advancements in technology and concomitant access to information on foreign securities markets, this increased pool of U.S. investors is likely to have the sophistication necessary to interact with foreign broker-dealers.

The SEC has not addressed the parallel regulatory scheme at the state level that requires registration or licensing with the particular state securities regulator of broker-dealers effecting transactions in securities with investors located in the state.[6]

Unsolicited Trades: Paragraph (a)(1)

The SEC does not propose to amend the paragraph (a)(1) unsolicited trade exemption. It has, however, proposed interpretive guidance with respect to quotation systems. Under the proposed interpretation, U.S. distribution of foreign broker-dealers' quotations by a third-party system, regardless of whether the quotations are primarily distributed in foreign countries, would not be viewed as a form of solicitation, provided the third-party system or foreign broker-dealer did not initiate other contacts with U.S. investors. Such systems still would be prohibited from providing execution of foreign security transactions between U.S. investors and foreign broker-dealers.

Research: Paragraph (a)(2)

The proposed amendments to paragraph (a)(2) of Rule 15a-6 would modify that provision by permitting a foreign broker-dealer to provide research to qualified investors instead of major U.S. institutional investors. The proposed rule would retain the other conditions in paragraph (a)(2) of the current rule.[7]

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[5] In some cases, the new standard would be more strict. For example, the definition of qualified investor would eliminate the $5 million threshold applicable to employee benefit plans, but it would impose a requirement that a fiduciary make investment decisions on behalf of such plans, a criterion not applicable to plans under the U.S. institutional investor definition.

[6] Most states provide an exemption from registration or an exclusion from the definition of broker-dealer for entities that do business exclusively with certain specified institutions in the state. The list of institutions varies with each state but would often include most major U.S. institutional investors and in some cases even U.S. institutional investors as defined in current Rule 15a-6. However, none of the states, other than a very small minority, would allow a foreign broker-dealer to do business directly with an individual without registration or licensing under state law.

[7] Specifically, under the proposal: (1) the research report could not recommend the use of the foreign broker-dealer to effect trades in any security; (2) the foreign broker-dealer could not initiate contact with the qualified investor to follow up on research reports or otherwise induce or attempt to induce the purchase or sale of any security by the qualified investor; (3) the foreign broker-dealer would need to have a relationship with a registered broker-dealer as set forth in paragraph (a)(3) of proposed Rule 15a-6, and any transaction with the foreign broker-dealer in securities discussed in the research report would need to be effected according to proposed paragraph (a)(3); and (4) the research would not be provided to a qualified investor with any express or implied understanding that that person will direct commission income to the foreign broker-dealer.

Solicited Trades: Paragraph (a)(3)

Proposed Rule 15a-6 would eliminate the "chaperoning" aspects of paragraph (a)(3), but would require a foreign broker-dealer that induces or attempts to induce the purchase or sale of any security by a qualified investor to engage a U.S. registered broker-dealer under one of two alternative exemptive approaches. Under either approach, the foreign broker-dealer would have to (i) be regulated in a foreign country by a foreign securities authority,[8] and (ii) disclose the fact that it is so regulated to a qualified investor. Current paragraph (a)(3) does not require the foreign broker-dealer to be regulated by a foreign securities authority.

a. The Foreign Business Requirement Approach

Under one approach, a foreign broker-dealer could effect all aspects of a transaction in securities on behalf of a qualified investor, including maintaining custody of funds and securities, if at least 85 percent of the aggregate value of the securities that the foreign broker-dealer purchased or sold in transactions under paragraphs (a)(3) or (a)(4)(vi) of the proposed rule, as calculated on a rolling, two-year basis, derived from transactions in foreign securities, as defined in the proposed rule (the "Foreign Business Requirement"). "Foreign securities" would include both debt and equity securities of foreign private issuers,[9] and debt securities of issuers organized or incorporated in the United States if the distribution of such securities is entirely outside of the United States in compliance with Regulation S, as well as specified securities issued by foreign governments.

A U.S. registered broker-dealer would have to maintain copies of all books and records, including confirmations and statements issued by the foreign broker-dealer to the qualified investor, relating to any transaction effected by a foreign broker-dealer operating under the Foreign Business Requirement exemption. The proposed rules would permit the U.S. registered broker-dealer to maintain such books and records in the manner and for the period prescribed by the foreign securities authority regulating the foreign broker-dealer. The U.S. registered broker-dealer also could maintain such books and records with the foreign broker-dealer, provided that the U.S. registered broker-dealer makes a reasonable determination that any or all of such books and records could be furnished promptly to the SEC upon request.

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[8] "Foreign securities authority" is not defined in the text of proposed amendments to Rule 15a-6. Rather, the proposing release refers to section 3(a)(50) of the Exchange Act. Under section 3(a)(50), "foreign securities authority" means any foreign government, or any governmental body or regulatory organization empowered by a foreign government to administer or enforce its laws as they relate to securities matters."

[9] The rule would look to the foreign issuer definition in Rule 405 under the Securities Act of 1933 (the "Securities Act"), which means any foreign issuer other than a foreign government, except an issuer: (1) more than 50 percent of the outstanding voting securities of which are directly or indirectly owned of record by residents of the United States; or (2) to which any of the following apply: (i) the majority of the executive officers or directors are United States citizens or residents; (ii) more than 50 percent of the assets of the issuer are located in the United States; or (iii) the business of the issuer is administered principally in the United States. Rule 405 also prescribes how to determine outstanding voting securities held by U.S. residents.

Under the Foreign Business Requirement approach, the U.S. registered broker-dealer no longer would have to extend or arrange to extend credit, issue confirmations and account statements, comply with the SEC net capital rule, Rule 15c3-1 under the Exchange Act, with respect to transactions, or receive, deliver and safeguard funds and securities in connection with transactions in compliance with the SEC customer protection rule, Rule 15c3-3 under the Exchange Act. The foreign broker-dealer would need to disclose to the qualified investor that U.S. segregation requirements, U.S. bankruptcy protections and protections under the Securities Investor Protection Act of 1970 would not apply to any funds or securities of the qualified investor held by the foreign broker-dealer.

b. The Alternative Approach

Alternatively, the foreign broker-dealer could effect all aspects of a transaction in foreign securities with a qualified investor, but not take custody of the qualified investor's funds and securities, in which case it would not need to comply with the Foreign Business Requirement. Under this exemption, a U.S. registered broker-dealer would be responsible for maintaining books and records, including copies of all confirmations that the foreign broker-dealer issued to the qualified investors, relating to any transaction effected by the foreign broker-dealer under this exemption. The U.S. broker-dealer also would retain the obligation to deliver and safeguard the qualified investor's funds and securities in compliance with Rule 15c3-3. Unlike the current version of the Rule 15a-6, the U.S. registered broker-dealer would not have to effect the transaction in a foreign security; the foreign broker-dealer would do so. A U.S. registered broker-dealer, however, would be involved in effecting any transaction effected in the U.S. markets.

c. Chaperoning

Both the Foreign Business Requirement exemption and alternative exemption would eliminate the "chaperone" provisions of Rule 15a-6. An associated person of a U.S. registered broker-dealer would *not* need to accompany associated persons of foreign broker-dealers when such persons visited U.S. qualified investors in person. A "visit," for purposes of the proposed rule, would mean one or more trips to the United States over a calendar year that do not total more than 180 days in the aggregate. Moreover, an associated person of a U.S. registered broker-dealer would not have to participate in communications between associated persons of foreign broker-dealers and U.S. qualified investors (regardless of whether the communications are oral or electronic).

d. Qualification Standards

To rely on an exemption under either approach, a foreign broker-dealer, as under the current standard, would have to agree to provide the SEC with information related to the foreign broker-dealer's solicitation activities directed at qualified investors. Provision of information would be either upon the SEC's request or pursuant to agreement between the SEC (or other U.S. governmental entity) and any foreign securities authority.

The foreign broker-dealer would need to determine that its associated persons that effect transactions with qualified investors are not subject to statutory disqualification as defined in Exchange Act Section 3(a)(39). The U.S. registered broker-dealer intermediating the transaction makes this determination under current Rule 15a-6. The foreign broker-dealer also would have to maintain certain information, such as personal, biographical and disciplinary history information, about its associated persons and to make that information available upon request by the intermediating U.S. registered broker-dealer or the SEC. Proposed Rule 15a-6 would mandate that the foreign broker-dealer keep documentation of sanctions imposed by foreign securities authorities, foreign exchanges, or foreign associations.

Each foreign broker-dealer utilizing an exemption under Rule 15a-6 and each associated person of the foreign broker-dealer would have to submit to service of process for any civil action brought by, or proceeding before, the SEC or a self-regulatory organization.

Under the proposed rule, the intermediating U.S. registered broker-dealer would be responsible for obtaining from the foreign broker-dealer a representation that it has in its files and would make available upon request by the U.S. registered broker-dealer or the SEC the requisite personal, biographical and disciplinary history information about its associated persons. The proposed rule also would require the U.S. registered broker-dealer to maintain records of the foreign broker-dealer's written consents and make these records available upon request.

U.S. Resident Fiduciaries of Foreign Resident Clients: Paragraph (a)(4)(vi)

The proposed rule would add a new exemption to paragraph (a)(4) to permit a foreign broker-dealer to effect transactions with or for any U.S. resident fiduciaries, for "foreign resident clients," as defined in the rule,[10] other than a broker-dealer or a bank acting pursuant to an exception or an exemption from the definition of broker or dealer. According to the SEC, foreign resident clients of a U.S. resident fiduciary would not reasonably expect the U.S. broker-dealer regulatory requirements to apply to their transactions in foreign securities. The text of the proposed rule amendment, however, does not limit the scope of the exemption to foreign securities. Moreover, the proposing release notes the foreign resident clients exemption would

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[10] Proposed Rule 15a-6(b)(4) states as follows:

The term foreign resident client shall mean:

(i) Any entity not organized or incorporated under the laws of the United States and not engaged in a trade or business in the United States for federal income tax purposes;
(ii) Any natural person not a U.S. resident for federal income tax purposes; and
(iii) Any entity not organized or incorporated under the laws of the United States 85 percent or more of whose outstanding voting securities are beneficially owned by persons in paragraphs (b)(4)(i) and (b)(4)(ii) of this section.

This definition appears to be a "codification" of the position that the SEC staff took in the Seven Firms Letter.

be available only to foreign broker-dealers that comply with the Foreign Business Requirement. The text of the proposed rule amendment, however, does not indicate that the exemption is limited to foreign broker-dealers complying with the Foreign Business Requirement.

Familiarization with Foreign Options Exchanges: Paragraph (a)(5)

The proposed rule would add a new paragraph (a)(5) that would permit a foreign broker-dealer that is a member of a foreign options exchange to effect transactions in options on foreign securities listed on that exchange for a qualified investor that has not otherwise been solicited by the foreign broker-dealer.[11] A foreign broker-dealer, a foreign options exchange and representatives of the foreign options exchange would be permitted to conduct certain activities or communicate with qualified investors in a manner that might otherwise be considered a form of solicitation. The parties could discuss the options exchanges, the options on foreign securities traded on those exchanges, and the exchanges' OTC options process services, as defined in the proposed rule, among other things, with a qualified investor. The SEC notes, however, that repeated transactions by foreign broker-dealers with qualified investors would probably require compliance with section (a)(3) of the proposed new Rule 15a-6. A foreign options exchange that engaged in the limited activities described in the proposed rule would not be subject to registration as a national securities exchange in the U.S.

The SEC notes that under proposed paragraph (a)(5), a qualified investor who engages in options transactions on a foreign options exchange would not become a direct member of or participant in a foreign options exchange or a foreign clearing organization; rather, transactions would be conducted through the foreign broker-dealer. The SEC also takes the position that the foreign clearing organization would not have to register as a clearing agency under Exchange Act Section 17A because only the foreign broker-dealer would have direct access to the foreign clearing organization to clear and settle foreign securities transactions under proposed paragraph (a)(5).

Finally, the SEC notes that foreign options transactions generally will involve the offer and sale of a security by an issuer of the security. Unless the foreign options were registered under the Securities Act, a foreign options transaction involving a U.S. qualified investor would need to come within an exemption from registration.

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[11] The Commission staff has issued a series of no-action positions to permit foreign options exchanges to familiarize certain U.S. registered broker-dealers and large U.S. institutional investors with their markets. *See, e.g.,* Letter re: EDX London Limited, OM London Exchange Limited-Standardized and Flexibly Structured Swedish, Norwegian, and Danish Stock Options and Standardized and Flexibly Structured OMX Index, OBX Index, and KFX Index Options (Oct. 29, 2003). Proposed paragraph (a)(5) would permit foreign options exchanges to familiarize qualified investors with their markets, significantly broadening the scope of investors who may be contacted by such exchanges as compared to the staff's no-action positions.

Scope

Proposed new Rule 15a-6 would not only exempt a foreign broker-dealer from registration under the Exchange Act, but also from the reporting and other requirements of the Exchange Act and the rules and regulations thereunder that apply to a broker-dealer by virtue of its status as such. A foreign broker-dealer would not be exempt from Exchange Act provisions, however, that are not specific to broker-dealers (Rule 10b-5, for example). Proposed Rule 15a-6 would supersede all no-action letters issued under Rule 15a-6 after its adoption in 1989. Finally, the proposed amendments to Rule 15a-6 are not a part of the Commission's mutual recognition efforts, under which the SEC is working with foreign regulators to develop a regime in which brokers regulated in one country would not have to obtain a license to conduct certain business in jurisdictions that are part of the mutual recognition regime.

Practical Concerns

In addition to allowing foreign broker-dealers greater access to U.S. qualified investors, the adoption of the proposed amendments will require U.S. and foreign broker-dealers and market participants to review their current arrangements, agreements, policies and procedures concerning cross border business to determine if the proposed amendments would necessitate changes or afford new opportunities. Foreign broker-dealers also should be comfortable that they are regulated by a foreign securities authority if they wish to rely on paragraph (a)(3) of the proposed amendments.

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