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SEC Proposes Amendments to Rule 15a-6 for Non-U.S. Broker-Dealers

The SEC recently proposed amendments to Rule 15a-6 under the Securities Exchange Act of 1934 (the "Exchange Act"), which provides certain exemptions for non-U.S. broker-dealers from the registration requirements of Section 15(a) of the Exchange Act. Currently, a non-U.S. broker-dealer may not solicit securities transactions from or provide research reports to U.S. investors without first registering with the SEC. The current rule permits a non-U.S. broker-dealer that is not SEC registered to accept unsolicited transactions and deal with SEC registered broker-dealers, certain supranational institutions and clients temporarily in the U.S. Under the rule, the non-U.S., nonregistered broker-dealer may also solicit transactions for institutional investors and major institutional investors provided that a U.S. registered broker-dealer "chaperones" the non-U.S. broker-dealer's activities and intermediates any resulting transactions. The proposed amendments would expand the categories of U.S. investors a non-U.S. broker-dealer may solicit transactions and provide research reports and would reduce the chaperoning and intermediary roles played by U.S. broker-dealers in transactions effected by the non-U.S. broker-dealer on behalf of certain U.S. investors.

I. Background

Generally, Section 15(a) of the Exchange Act provides that a broker or dealer that effects transactions in, or solicits the purchase or sale of, any security must register with the SEC. The SEC uses a territorial approach to the broker-dealer registration requirement. Under this approach, broker-dealers located inside the United States must register with the SEC, even if they conduct securities transactions with persons outside the United States (i.e., non-U.S. persons). Under the territorial approach non-U.S. broker-dealers operating outside the United States that conduct securities transactions for any person inside the United States must also register with the SEC. Only entities that conduct their securities activities entirely outside the United States securities do not have to register.[1] Last, the territorial approach also requires registration of non-U.S. broker dealers operating outside the United States that effect, induce or attempt to induce securities transactions for any person inside the United States.

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[1] Because this territorial approach applies on an entity level, not a branch level, if a non-U.S. broker-dealer establishes a branch in the United States, broker-dealer registration requirements would extend to the entire non-U.S. broker-dealer entity. However, the registration requirement does not apply to a non-U.S. broker-dealer with an affiliate, such as a subsidiary, operating in the United States. Only the U.S. affiliate must register and only the U.S. affiliate may engage in securities transactions and perform related functions on behalf of U.S. investors.

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II. The Current Regulatory Framework under Rule 15a-6

Under Rule 15a-6, non-U.S. broker-dealers may:

(i) execute unsolicited securities transactions for U.S. investors,

(ii) provide research reports to major U.S. institutional investors and effect related transactions under the Rule,

(iii) solicit and execute transactions through a registered broker-dealer intermediary for U.S. institutional investors and major institutional investors, and

(iv) solicit and execute transactions without this intermediary for certain entities such as registered broker-dealers, banks acting in a broker or dealer capacity and certain supranational [2] organizations.

A. *Unsolicited Trades*

Paragraph (a)(1) of 15a-6 provides an exemption for a non-U.S.-broker dealer that effects unsolicited securities transactions with U.S. persons. Although solicitation is construed broadly, registration is not necessary if a U.S. investor initiated a transaction with a non-U.S. broker-dealer entirely by his or her own accord and the non-U.S. broker-dealer did not make any affirmative effort to induce transactional activity with the U.S. investor.[3]

B. *Providing Research Reports*

Providing research to U.S. investors is a solicitation that triggers broker-dealer registration because the broker-dealers provide research to customers expecting that the customer eventually will trade through them. Paragraph (a)(2) of Rule 15a-6 provides an exemption from U.S. broker-dealer registration for non-U.S. broker-dealers that provide research reports to major U.S. institutional investors if:

(i) the research reports do not recommend that the investor use the non-U.S. broker-dealer to effect trades in any security,

(ii) the non-U.S. broker-dealer does not initiate follow up contacts or otherwise attempt to solicit investors to effect transactions in any security,

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[2] The organizations are the African Development Bank, the Asian Development Bank, the Inter-American Development Bank, the International Bank for Reconstruction and Development, the International Monetary Fund, the United Nations.

[3] For example, telephone calls to U.S. investors, advertising circulated or broadcast in the United States and holding investment seminars in the United States, regardless of whether the seminars were hosted by a registered broker-dealer are forms of solicitation. Solicitation also includes recommending the purchase or sale of securities to customers or prospective customers for the purpose of generating transactions or sending research and following up with the U.S. investors.
Non-U.S. broker-dealers that have Internet Web sites and that intend to rely on Rule 15a-6's 'unsolicited' exemption should ensure that the `unsolicited' customer's transactions are not in fact solicited, either directly or indirectly or indirectly, through customers accessing their Websites.

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(iii) transactions with the non-U.S. broker-dealer in securities covered by the research reports are effected through a registered broker-dealer according to paragraph (a)(3) of Rule 15a-6, described below, and

(iv) providing the research is not part of an understanding that the non-U.S. broker-dealer will receive commission income from transactions effected by U.S. investors.

Under the rule, a "major U.S. institutional investor" as (i) a U.S. institutional investor that has, or manages, total assets of over $100 million; or (ii) a registered investment adviser that manages assets of over $100 million.

C. *Solicited Trades*

Many non-U.S. broker-dealers prefer to deal with institutional investors in the United States from their overseas trading desks, where their dealer operations and principal sources of current information on foreign market conditions and foreign securities are based. Similarly, many U.S. institutions want direct contact with the overseas traders.

Paragraph (a)(3) of Rule 15a-6 permits non-U.S. broker-dealers to solicit major U.S. institutional investors and U.S. institutional investors, if a U.S. registered broker-dealer intermediates the transactions.[4] The U.S. registered broker-dealer must:

(i) issue confirmations and account statements,

(ii) extend or arrange for the extension of any credit to the investors,

(iii) maintain the books and records,

(iv) maintain sufficient net capital,

(v) receive, deliver and safeguard investor funds and securities for the transactions in compliance with the customer protection rule (i.e., Rule 15c3-3 under the Exchange Act), and

(vi) take responsibility for certain key sales activities, including "chaperoning" the contacts of foreign associated persons with certain U.S. institutional investors.

Under the rule a "U.S. institutional investor" is (i) a U.S. registered investment company; or (ii) a bank, savings and loan association, insurance company, business development company, small business investment

[4] The SEC recognized that rules of foreign securities exchanges and over-the-counter markets may require the non-U.S.-broker-dealer, as a member or market maker, to perform the actual physical execution of transactions in foreign securities listed on those exchanges or traded in those markets. Accordingly, while the SEC does not believe that it is appropriate to allow the U.S. registered broker-dealer to delegate the performance of its duties under the rule to the non-U.S. broker-dealer, it does permit delegation of physical execution of foreign securities trades in foreign markets or on foreign exchanges. As a result, the treatment of U.S. securities and foreign securities under paragraph (a)(3) of the rule differs. Specifically, for foreign securities the non-U.S. broker-dealer may not only negotiate the terms, but also execute the transactions. However, for U.S. securities, the U.S. broker-dealer must execute the transactions and comply with the provisions of the federal securities laws, the rules thereunder and SRO rules for the execution of transactions.

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company, or employee benefit plan defined in Rule 501(a)(1) of Regulation D under the Securities Act of 1933 ("Securities Act"); a private business development company defined in Rule 501(a)(2); an organization described in Section 501(c)(3) of the Internal Revenue Code, as defined in Rule 501(a)(3); or a trust defined in Rule 501(a)(7); and interpretations have extended this to include hedge funds and other entities.

D. *Counterparties and Specific Customers*

Paragraph (a)(4) of Rule 15a-6 permits non-U.S. broker-dealers to solicit or effect transactions in securities for the following persons: (1) registered broker-dealers (acting either as principal or agent) or banks acting under an exception or exemption from broker-dealer registration;[5] (2) certain supranational organizations and their agencies, affiliates and pension funds; (3) foreign persons temporarily present in the United States with whom the non-U.S. broker-dealer had a pre-existing relationship; (4) any agency or branch of a U.S. person permanently outside the United States; and (5) U.S. citizens resident outside the United States, where the transactions occur outside the United States and the non-U.S. broker-dealer does not direct its solicitations to identifiable groups of U.S. citizens resident outside the United States.

III. Proposed Amendments

A. *Extension of Rule 15a-6 to Qualified Investors*

The proposed rule would expand the category of U.S. investors to which a non-U.S. broker-dealer could provide research and with which a non-U.S. broker-dealer could interact by replacing the 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. Section 3(a)(54) of the Exchange Act.[6] defines a "qualified investor" as:

(i) any registered investment company;

(ii) a private investment company excluded from the definition of investment company under Section 3(c)(7) of the Investment Company Act;

(iii) any bank, savings association, broker, dealer, insurance company, or business development company;

(iv) any small business investment company licensed by the U.S. Small Business Administration;

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[5] While the exemption allows non-U.S. broker-dealers to effect transactions with or for certain banks or registered broker-dealers, it does not allow direct contact by non-U.S. broker-dealers with the U.S. customers of the registered broker-dealers or banks. See 1989 Adopting Release, 54 FR at 30013 n.202.

[6] The definition of "qualified investor" was added to the Exchange Act by the Gramm-Leach-Bliley-Act of 1999 and applies to several of the bank exceptions from broker-dealer registration, including: (1) the broker exception for identified banking products when the product is an equity swap agreement, (2) the dealer exception for identified banking products when the product is an equity swap agreement, and (3) the dealer exception for asset backed securities. These exceptions permit banks to sell certain securities to qualified investors without registering as broker-dealers with the SEC.

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(v) any state sponsored employee benefit plan, or any other ERISA employee benefit plan, other than an individual retirement account, if the investment decisions are made by a plan fiduciary, which is either a bank, savings and loan association, insurance company, or registered investment adviser;

(vi) any trust whose purchases of securities are directed by a person described in clauses (i) through (v) above;

(vii) any market intermediary exempt under Section 3(c)(2) of the Investment Company Act;

(viii) any associated person of a broker or dealer other than a natural person;

(ix) any foreign bank;[7]

(x) the government of any foreign country;[8]

(xi) any corporation, company, partnership or natural person that owns and invests on a discretionary basis at least $25,000,000 in investments;

(xii) any government or government instrumentality that owns and invests on a discretionary basis at least $50,000,000 in investments; or

(xiii) any multinational or supranational entity or any agency or instrumentality thereof.

The proposed rule cleans up the types of entities subject to its relief and reduces the threshold value of assets owned or invested needed to qualify. Under the proposed rule the investment test would be reduced from institutional investors that own or control more than $100 million in total assets to, among others, registered investment companies and corporations, companies, or partnerships that own or invest on a discretionary basis $25 million or more in investments. The proposed rule would also add natural persons who own or invest on a discretionary basis at least $25,000,000 in investments.

Additionally, only employee benefit plans that have a fiduciary making investment decisions for the plan would be qualified investors. Similarly, only trusts whose purchases are directed by certain entities would be qualified investors. Last, the qualified investors would exclude private business development companies as defined in Section 202(c)(22) of the Investment Advisers Act and certain organizations described in Section 501(c)(3) of the Internal Revenue Code with assets of $5 million or more.

B. *Providing Research Reports*

As proposed, paragraph (a)(2) of Rule 15a-6 would expand the class of investors to which the non-U.S. broker-dealer could provide research reports directly and effect transactions in the securities discussed in the research report from major U.S. institutional investors to qualified investors.

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[7] The definition of qualified investor includes any foreign bank. Unlike foreign governments, foreign banks may establish a permanent presence in the United States, such as a branch, that would not qualify under Exchange Act Section 3(a)(6) as a bank. Non-U.S. broker-dealers need to rely on Rule 15a-6 to effect transactions with such entities. 8 Non-U.S. broker-dealers currently do not need to rely on Rule 15a-6 to effect transactions with foreign governments because foreign governments are neither located in the United States nor U.S. persons resident abroad.

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Specifically, proposed paragraph (a)(2) of Rule 15a-6 would be available, if: (1) the research reports do not recommend the use of the non-U.S. broker-dealer to effect trades in any security; (2) the non-U.S. broker-dealer does not initiate contact with the qualified investors to follow up on the research reports and does not otherwise solicit the purchase or sale of any security by the qualified investors; (3) if the non-U.S. broker dealer has a relationship with a registered broker that complies with proposed paragraph (a)(3) of Rule 15a-6, any transactions with the non-U.S. dealer in securities discussed in the research reports are effected under paragraph (a)(3); and (4) the non-U.S. broker-dealer does 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 non-U.S. broker-dealer.

C. *Solicited Trades*

The proposed rule would significantly reduce and streamline the conditions under which a non-U.S. broker-dealer could solicit certain U.S. investors, and, in certain situations, permit a non-U.S. broker-dealer to provide full-service brokerage for qualified investors.

1. Customer Relationship

Currently, Rule 15a-6 requires a non-U.S. broker-dealer that solicits a U.S. investor to engage a U.S. registered broker-dealer to perform certain services. The proposed Rule provides two exemptive approaches, that reduce the role of the U.S. registered broker-dealer and increase the role of non-U.S. broker-dealer in effecting any resulting transactions. Both proposed exemptions would allow qualified investors more direct contact with the personnel of the non-U.S. broker-dealer, without certain barriers, i.e., the chaperoning requirement would be removed and visits by employees of the non-U.S. broker-dealers would be permitted to qualified investors in the United States up to a maximum of 180 days a year.

There are two primary differences between the two proposed exemptive approaches. First, under Exemption (A)(1) (i.e., proposed Rule 15a-6(a)(3)(iii)(A)(1)) non-U.S. broker-dealers that conduct a "foreign business" would be permitted to custody funds and securities of qualified investors for transactions. In contrast, Exemption (A)(2) (i.e., proposed Rule 15a-6(a)(3)(iii)(A)(2)) could be used by all non-U.S. broker-dealers, but they would not be permitted to custody funds or securities for qualified investors.

a. Exemption (A)(1): Full Service Non-U.S. Broker-Dealer

Proposed Exemption (A)(1) would permit a non-U.S. broker-dealer that conducts a "foreign business" and is regulated by a foreign securities authority to provide full service brokerage services to certain U.S. investors, including effecting transactions and maintaining custody of funds and securities from those transactions.

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i. Role of the U.S. Registered Broker-Dealer

Under Exemption (A)(1), the intermediating U.S. registered broker-dealer would not be required to effect all aspects of the transactions. The intermediating U.S. registered broker-dealer would no longer be required to: (i) extend or arrange for the extension of credit, (ii) issue confirmations and account statements, (iii) comply with the net capital Rule (Rule 15c3-1) for the transactions, (iv) receive, deliver and safeguard funds and securities for the transactions in compliance with the customer protection rule (Rule 15c3-3), (v) maintain accounts for the customers of non-U.S. broker-dealers relying on Exemption (A)(1), or (vi) comply with the requirements for broker-dealers that maintain such accounts.

Books and Records

For transactions effected by a non-U.S. broker-dealer under proposed Exemption (A)(1), the U.S. registered broker-dealer must maintain copies of all books and records relating to the transactions, including confirmations and statements issued by the non-U.S. broker-dealer to the qualified investor. The non-U.S. broker-dealer would generate books and records relating to the transactions and proposed Exemption (A)(1) would allow the U.S. registered broker-dealer to maintain those books and records with the non-U.S. broker-dealer, in the form, manner and for the periods prescribed by the foreign securities authority in regulating the non-U.S. broker-dealer.[9] However, the U.S. registered broker-dealer must make a reasonable determination that copies of all of those books and records could be furnished promptly to the SEC upon request, and it promptly provides any such books and records to the SEC. In making this determination, the U.S. registered broker-dealer must consider, among other things, any legal limitations in the foreign jurisdiction that might limit the ability of the non-U.S. broker-dealer to disclose information relating to transactions effected under proposed Exemption (A)(1) to the U.S. registered broker-dealer.[10]

ii. Role of the Non-U.S. Broker-Dealer

The Foreign Business Requirement

Exemption (A)(1) would only be available to non-U.S. broker-dealers that conduct a "foreign business." "Foreign business" would be defined to mean that at least 85% of the aggregate value of the securities purchased or sold in transactions conducted by the non-U.S. broker-dealer under both Exemptions (A)(1) and

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[9] Under the proposed rule, the term "foreign securities authority" has the same meaning as in Section 3(a)(50) of the Exchange Act, which defines "foreign securities authority" to mean "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."
However, this would not change any books and recordkeeping obligations a U.S. registered broker-dealer may have under Exchange Act Rules 17a-3 and 17a-4.

10 Consequently, the U.S. registered broker-dealer may not have obligations under Exchange Act Rule 17a-8 for customers of non-U.S. broker-dealers relying on Exemption (A)(1). Rule 17a-8 requires a U.S. registered broker-dealer to comply with the reporting, recordkeeping and record retention requirements in regulations implemented under the Bank Secrecy Act. Current Rule 15a-6 permits an unregistered non-U.S. broker-dealer to effect transactions directly with U.S. persons on an unsolicited basis, and to solicit certain U.S. institutional investors by means of research reports and effect transactions in securities discussed in such reports, subject to certain conditions, in either case without intermediation by a U.S. registered broker-dealer subject to Rule 17a-8.

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(A)(2) or under the proposed exemption for transactions with U.S. persons acting in a fiduciary capacity for a non-U.S. resident customer (collectively, "Exempt Transactions"), calculated on a rolling two-year basis, is derived from transactions in foreign securities. "Foreign securities" would include: (a) debt and equity securities of foreign private issuers, (b) debt securities of U.S. issuers that are distributed wholly outside the United States under Regulation S, (c) debt securities issued or guaranteed by a foreign government that is eligible to be registered with the SEC under Schedule B of the Securities Act, and (d) a derivative instrument on one of the foregoing securities if the debt security itself is a security.

The proposed rule would require the non-U.S. broker-dealer to compute the absolute value of all Exempt Transactions (i.e., without netting the transactions) each year to determine the aggregate amount for the previous two years. For example, if a non-U.S. broker-dealer sold 100 shares of Security A at $10.00 per share and bought 100 shares of Security A at $10.00 per share in Exempt Transactions it would have an aggregate value of securities bought and sold of $2,000.00 (i.e., (100 x $10.00) + (100 x $10.00)).

For derivative instruments that are securities, the valuation would depend on the product. For example, the value of options on a security or group or index of securities bought or sold would be the premium paid by the buyer, not the value of the underlying security or securities. Similarly, the value of a security future would be the price times the number of securities to be delivered when the transaction is entered into.[11]

The calculation of the composition of the non-U.S. broker-dealer's business on a rolling, two-year basis would mean that, after the first year the non-U.S. broker-dealer relies on the exemption, the non-U.S. broker-dealer would calculate the aggregate value of securities purchased and sold for the prior two years to determine whether it has complied with the foreign business test to be eligible for proposed Exemption (A)(1). A non-U.S. broker-dealer could elect to use a calendar year or the firm's fiscal year for complying with the foreign business test. Additionally, to provide non-U.S. broker-dealers sufficient time to obtain and verify the relevant aggregate value data, the proposed rule would allow non-U.S. broker-dealers to rely on the calculation made for the prior year for the first 60 days of a new year. Accordingly, a non-U.S. broker-dealer that had a foreign business during years 1 and 2 would be deemed to have a foreign business for the first 60 days of year 4, regardless of the result of the calculation for year 3.

Foreign Oversight

The proposed Exemption (A)(1) would be available only to non-U.S. broker-dealers that are regulated for conducting securities activities in a foreign country by a non-U.S. securities authority, including the specific activities in which the non-U.S. broker-dealer engages with the qualified investor.

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[11] Non-U.S. broker-dealers would not need to include the value of swap agreements that meet the definition of "swap agreement" in Section 206A of the Gramm-Leach-Bliley Act ("GLBA") in the foreign business test calculation because they are excluded from the definition of security.

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Disclosure

Both Exemption (A)(1) and Exemption (A)(2) would require the non-U.S. broker-dealer to disclose to the qualified investor that it is regulated by a foreign securities authority and not by the SEC. Unlike under Exemption (A)(2), the non-U.S. broker-dealer operating under proposed Exemption (A)(1) would also be required to disclose that it is not subject to the same regulatory requirements as U.S. registered broker-dealers, i.e., that U.S. segregation requirements (e.g., the requirement that customer funds and assets be segregated from the broker-dealer's own proprietary funds and assets), U.S. bankruptcy protections (e.g., preference to creditors in bankruptcy) and protections under the Securities Investor Protection Act ("SIPA")[12] will not apply to any funds and securities of the qualified investor held by the non-U.S. broker-dealer.

b. Exemption (A)(2): U.S. Broker-Dealer Maintains Accounts and Custody of Fund of Securities from U.S. broker-dealers

Proposed Exemption (A)(2) is intended for non-U.S. broker-dealers that would like to solicit transactions from qualified investors that have accounts and custody their funds and securities, with U.S. registered broker-dealers. Under Exemption (A)(2) non-U.S. broker-dealers need not conduct a foreign business.

i. Role of the U.S. Registered Broker-Dealer

Custody of Funds and Securities

Under Exemption (A)(2), the non-U.S. broker-dealer could effect a transaction with a qualified investor and provide clearance and settlement, but the U.S. broker-dealer must maintain custody of the qualified investors' funds and securities in accordance with SEC customer protection rules.

Books and Records

Under Exemption (A)(2), the U.S. broker-dealer must maintain books and records for the transaction, including copies of all confirmations issued by the non-U.S. broker-dealer to the qualified investor.

ii. Role of the Non-U.S. Broker-Dealer

Foreign Oversight

Like Exemption (A)(1), Exemption (A)(2) would only be available to non-U.S. broker-dealers that are regulated for conducting securities activities by a non-U.S. securities authority, including the specific activities in which the non-U.S. broker-dealer engages with the qualified investor.

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[12] The SIPA created the Securities Investor Protection Corporation ("SIPC"), a nonprofit, private membership corporation to which most registered brokers and dealers must belong, and established a fund administered by SIPC designed to protect the customers of brokers or dealers subject to the Act from loss in case of financial failure of the member.

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Disclosure

The non-U.S. broker-dealer relying on Exemption (A)(2) would be required to disclose to the qualified investor that the non-U.S. broker-dealer is regulated by a non-U.S. securities authority and not by the SEC. However, unlike under Exemption (A)(1), the non-U.S. broker-dealer relying on Exemption (A)(2) would not be required to provide disclosures to the qualified investor regarding segregation requirements, U.S. bankruptcy protections and protections under SIPA because the U.S. registered broker-dealer would be maintaining custody of investor funds and securities.

2. Securities Law Compliance

Unlike under the current rule, under both Exemptions (A)(1) and(A)(2), the intermediating U.S. registered broker-dealer would not be required to effect the transaction.[13] Thus, for transactions effected under Exemption (A)(2), the intermediating U.S. registered broker-dealer would no longer be required to comply with the provisions of the federal securities laws, related rules and broker-dealer SRO rules for effecting a transaction in securities, unless it were otherwise involved in effecting the transaction. However, if a non-U.S. broker-dealer effects a transaction under Exemption (A)(2) on a U.S. national securities exchange, through a U.S. alternative trading system, or with a market maker or an over-the-counter dealer in the United States, a U.S. registered broker-dealer would be involved in effecting the transaction and would be required to comply with the provisions of the federal securities laws, related rules and SRO rules for that activity. In other words, those provisions would apply for all transactions in U.S. securities under Exemption (A)(2) other than certain over-the-counter transactions that a non-U.S. broker-dealer does not effect by or through a U.S. registered broker-dealer.

3. Sales Activities

The proposed rule would eliminate the current requirement for an associated person of a U.S. registered broker-dealer to participate in communications (oral or electronic) between foreign associated persons and U.S. investors (the so-called "chaperoning requirement"). Specifically, the proposed rule would not limit a non-U.S. broker-dealer's ability to have unchaperoned communications (oral and electronic), with qualified investors, as part of a transaction under either exemption in paragraph (a)(3) of the proposed rule.

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[13] Under Exemption (A)(2), the non-U.S. broker-dealer would be permitted to clear and settle the transactions on behalf of the U.S. registered broker-dealer. The SEC believes that this is appropriate for transactions effected under Exemption (A)(2) for investors that possess the sophistication of qualified investors, particularly given that the exemption would require a U. S. registered broker-dealer to maintain books and records and receive, deliver and safeguard funds and securities in connection with the transactions.

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Additionally, both proposed Exemption (A)(1) and Exemption (A)(2) would eliminate the requirement in current Rule 15a-6(a)(3) for foreign associated persons[14] to be accompanied by an associated person of a U.S. registered broker-dealer during in-person visits with U.S investors. The proposed rule would provide that a foreign associated person may conduct unchaperoned visits to qualified investors within the United States, provided that transactions in any securities discussed during visits by the foreign associated person with qualified investors are effected under either exemption in paragraph (a)(3). The SEC proposed to interpret a "visit" as one or more trips to the United States over a calendar year that do not last more than 180 days in the aggregate.

4. Qualification Standards

Non-U.S. broker-dealers intending to rely on proposed Rule 15a-6(a)(3) would need to meet certain qualification requirements. As under the current rule, the non-U.S. broker-dealer would be required to provide the SEC, upon request or under agreement between the SEC or the United States and any foreign securities authority, information or documents related to the non-U.S. broker-dealer's activities in soliciting securities transactions by qualified investors.

The proposed rule would require the non-U.S. broker-dealer to determine that its associated persons that effect transactions with qualified investors are not subject to a statutory disqualification under Section 3(a)(39) of the Exchange Act. This would be a change from the current rule, which requires the U.S. registered broker-dealer intermediating the transaction to make this determination. The proposed rule would require the U.S. registered broker-dealer to obtain a representation from the non-U.S. broker-dealer that the non-U.S. broker-dealer has actually determined that any foreign associated person of the non-U.S. broker-dealer effecting transactions with the qualified investor is not subject to a statutory disqualification under section 3(a)(39) of the Exchange Act, and that it has in its files and it would make available upon request by the U.S. registered broker-dealer or the SEC, the types of personal information specified in Rule 17a-3(a)(12) under the Exchange Act. This information would include the foreign associated person's identifying information, list of last ten years business connections, disciplinary history and criminal history.

Like the current rule, proposed Rule 15a-6(a)(3) would require the U.S. registered broker-dealer to obtain from the non-U.S. broker-dealer and each foreign associated person written consent to service of process for any civil action brought by or proceeding before the SEC or a self-regulatory organization. Finally, the proposed rule would require the U.S. registered broker-dealer to maintain records of the written consents and representations discussed above and make these records available to the SEC on request.

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[14] The proposed rule would retain the definition of "foreign associated person" that is in paragraph (b)(2) of the current Rule 15a-6, but would substitute "qualified investor" for "U.S. institutional investor or major U.S. institutional investor" in the definition. See proposed Rule 15a-6(b)(1).

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D. *Unsolicited Trades - Third Party Systems Distributing Non-U.S. Quotes*

The amended Rule would continue the existing exception for unsolicited securities transactions. Because the SEC construes solicitation broadly, the SEC proposed further interpretive guidance related to solicitation for third party quotation systems distributing quotes of non-U.S. broker-dealers.

Under the proposed interpretation, third party quotation systems may distribute non-U.S. broker-dealers' quotations in the United States, such as systems operated by non-U.S. marketplaces or by private vendors, provided the third-party systems do not allow securities transactions to be executed between the non-U.S. broker-dealer and persons in the United States through the systems.[15] The third party systems would not be viewed as solicitation, in the absence of other contacts with U.S. investors initiated by the third-party system or the non-U.S. broker-dealer.

Under the SEC's proposed interpretation, the SEC's previous guidance on U.S. distribution of non-U.S. broker-dealers' quotations by third-party systems no longer would be limited to third-party systems that distributed their quotations primarily in foreign countries.

E. *Counterparties and Specific Customers*

As in the current rule, proposed paragraph (a)(4) of Rule 15a-6 would provide exemptions for non-U.S. broker-dealers that solicit or effect securities transactions by:

a. registered U.S. broker-dealers, acting as principal or agent, or a bank acting under an exemption from U.S. broker-dealer registration;

b. certain supranational organizations;

c. non-U.S. persons temporarily resident in the United States with whom the non-U.S. broker-dealer has a pre-existing relationship;

d. a branch or agency of a U.S. person permanently located outside of the United States; and

e. U.S. citizens resident outside the United States so long as the non-U.S. broker-dealer does not direct is selling efforts toward any group of U.S. citizens resident abroad.

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[15] For example, the SEC stated that a non-U.S. broker-dealer whose quotations were displayed in a system that disseminated quotes only for large block trades might well be deemed to have engaged in solicitation requiring broker-dealer registration, as opposed to a non-U.S. broker-dealer whose quotes were displayed in a system that disseminated the quotes of numerous non-U.S. dealers or market makers in the same security.
The current SEC interpretation on the subject does not preclude a non-U.S. broker-dealer from directly inducing U.S. investors to trade with the non-U.S. broker-dealer via a quotation system controlled by the non-U.S. broker-dealer (i.e., not a third-party system) where the U.S. investor subscribes to the quotation system through a U.S. broker-dealer, the U.S. broker-dealer has continuing access to the quotation system, the non-U.S. broker-dealer's other contacts with the U.S. investor are permissible under the current rule and any resulting transactions are intermediated in accordance with Rule 15a-6(a)(3).

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The SEC proposed to add an exemption for transactions with U.S. resident fiduciaries of accounts for "foreign resident clients." This proposed exemption would be available only to a non-U.S. broker-dealer that conducts a foreign business. [16] The proposed rule would define "foreign resident client" to 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% or more of whose outstanding voting securities are beneficially owned by persons in subparagraphs (i) and (ii) above.[17]

Additionally, the non-U.S. broker-dealer would be required to obtain a written representation from the U.S. fiduciary that the account is managed in a fiduciary capacity for a foreign resident client.[18]

F. *Familiarization with Foreign Options Exchanges*

1. Exchange Act Section 15(a)

The SEC is proposing a new exemption and codifying interpretive guidance which are intended to provide legal certainty for non-U.S. options exchanges to enable them to engage in limited activities to familiarize U.S. investors with options on foreign securities traded on those exchanges and the exchange's related services. Paragraph (a)(5) of proposed Rule 15a-6 would allow a non-U.S. 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 non-U.S. broker-dealer. Under this exemption, a non-U.S. broker-dealer, a foreign options exchange and representatives of the foreign options exchange could conduct certain activities or communicate with a qualified investor in a manner that might otherwise be considered a solicitation, as described below. While the permitted activities would not necessarily constitute a solicitation, the SEC anticipates that given its broad interpretation of solicitation, it would be difficult, if not impractical, to conduct repeated transactions with the same qualified investor without the non-U.S. broker-

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[16] See proposed Rule 15a-6(b)(2)(ii).

[17] The SEC considers a person to be a control person if he or she directly or indirectly has the power to vote 25 percent or more of the voting securities or interests of an entity. The concept of control, which is found in all the statutes administered by the SEC, varies to some degree between statutes. Although the Exchange Act does not define "control," Rule 12b-2 under the Exchange Act defines "control" as "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise." This definition has been found to apply to all Exchange Act control determinations. In re Commonwealth Oil / Tesoro Petroleum Securities Litigation, 484 F. Supp. 253, 268 (W.D. Tex. 1979) (the right to vote 25 percent or more of the voting securities or is entitled to 25 percent or more of the profits is presumed to control that company).
The 85 percent threshold in proposed paragraph (b)(4)(iii) is designed to ensure that entities with U.S. control persons would not meet the proposed definition of "foreign resident client."

[18] 132 See proposed Rule 15a-6(a)(4)(vi)(B)

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dealer engaging in some form of communication that would constitute solicitation that would need to be completed under proposed Rule 15a-6(a)(3).

Paragraph (a)(5)(i) of proposed Rule 15a-6 would allow the representative of a foreign options exchange to communicate with persons that he or she reasonably believes are qualified investors regarding the foreign options exchange, the options on foreign securities traded on the foreign options exchange, and the foreign options exchange's "OTC options processing service."[19] These communications could include programs and seminars in the United States.

An "OTC options processing service" would be defined as a mechanism for submitting to a non-U.S. options exchange an options contract on a foreign security that has been negotiated and completed in an over-the-counter transaction for the foreign options exchange to replace that contract with an equivalent standardized options contract listed on the non-U.S. options exchange.

The proposed rule would permit a representative of a foreign options exchange to provide persons that the representative reasonably believes are qualified investors with a disclosure document that provides an overview of the foreign options exchange, the options traded on that exchange and upon the request of the investor, a list of participants on the foreign options exchange permitted to take orders from the public and any U.S. registered broker-dealer affiliates of those participants.

The proposed rule is intended to prevent a foreign options exchange and its representatives from soliciting on behalf of a particular non-U.S. broker-dealer or limited group of particular non-U.S. broker-dealers.

A non-U.S. broker-dealer would be permitted to make available to qualified investors the foreign options exchange's OTC options processing service. In response to an otherwise unsolicited inquiry concerning foreign options traded on the foreign options exchange, a non-U.S. broker-dealer would also be permitted to provide qualified investors, with a disclosure document that provides an overview of the foreign options exchange and the options on foreign securities traded on that exchange, including the differences from standardized options in the U.S. domestic options market and special factors relevant to transactions by U.S. entities in options on that exchange.[20] The non-U.S. broker-dealer could then effect transactions on a foreign options exchange of which it is a member for a qualified investor that has not been otherwise solicited by the non-U.S. broker-dealer.

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[19] See proposed Rule 15a-6(a)(5)(i)(A).

[20] See proposed Rule 15a-6(a)(5)(ii)(B). Exchange Act Rule 9b-1 requires an options market to file with the Commission an options disclosure document containing the information specified in Rule 19b-1(c). "Options markets" are defined in Rule 19b-1 to include foreign securities exchanges. See Exchange Act Rule 19b-1(a)(1), 17 CFR 240.19b-1(a)(1), 17 CFR 240.19b-1(a)(1). The SEC would not view the provisions of the options disclosure document, which contains, among other thins, a summary of the instruments traded and the mechanics of trading on that market, as a "research report" under proposed Rule 15a-69a)(2). See Parts II.B and III.C., supra.

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2. Exchange Act Section 6

The SEC is proposing to provide interpretive guidance that a foreign exchange would not be required to register as a national securities exchange under Section 6 of the Exchange Act if the foreign exchange, its representatives, or its non-U.S. broker-dealer members engaged in the limited activities and communications described in proposed paragraph (a)(5) of Rule 15a-6 described above. The SEC's proposed interpretation is based on its preliminary view that, although a foreign exchange's OTC options processing service may be a facility of an exchange, [21] the OTC options processing service would not effect any transaction in a security or report any such transaction. Accordingly, that activity would not trigger the registration requirement of Section 6 of the Exchange Act. [22]

3. Exchange Act Section 17A

Under proposed Rule 15a-6(a)(5), the foreign option exchange could not trade options on a U.S. security and the foreign clearing organization could not clear and settle options on U.S. securities for a non-U.S. broker-dealer member or participant relying on proposed paragraph (a)(5) for the transaction. Because only the non-U.S. broker-dealer would have direct access to the foreign clearing organization to clear and settle foreign securities transactions under proposed Rule 15a-6(a)(5) and the foreign clearing organization would not provide clearance and settlement services for U.S. securities directly to U.S. entities, the SEC does not believe that relief would be necessary from registration as a clearing agency under Section 17A of the Exchange Act.

4. Securities Act

Foreign option transactions that are effected through the facilities of a foreign exchange will generally involve the offer and sale of a security by an issuer of the security.[23] As a result, unless the foreign options were registered under the Securities Act, foreign option transactions involving U.S. persons would be required to be covered by an exemption from registration. To the extent that the activities undertaken by foreign options exchanges in the United States can be deemed to constitute offers of foreign options under the Securities Act, such activities must also be undertaken in a fashion that is consistent with the requirements of the applicable exemption. For example, to the extent that reliance is based on Securities Act Section 4(2), the activities of the foreign options exchange must not constitute a public offering of the securities. And, resales within the United States would have to be compliant under the Securities Act as well.

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[21] See Section 3(a)(2) of the Exchange Act (defining "facility" of an exchange).
[22] See Section 3(a)(1) of the Exchange Act, 15 U.S.C. 78c (defining "exchange") and Rule 3b-16 under the Exchange Act (further elaborating on the definition of "exchange" contained in the Exchange Act).
[23] With exchange traded options, the clearing house is the issuer of the option security. See Securities Act Release No. 8171 (Dec. 23, 2002), 68 FR 188, 188 (Jan. 2, 2003).

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G. *Scope of the Proposed Exemption*

The SEC proposes to amend Rule 15a-6 and use its general exemptive authority under Section 36 of the Exchange Act to exempt non-U.S. broker-dealers from not only the registration requirements of Sections 15(a)(1) or 15B(a)(1) of the Exchange Act, but also from the reporting and other requirements of the Exchange Act, and the rules and regulations thereunder, that apply specifically to a broker-dealer solely by virtue of its status as a broker or dealer rather than because of its registration with the SEC. However, non-U.S. broker-dealers would not be exempt from provisions of the Exchange Act, and the rules and regulations thereunder that are not specific to broker-dealers, such as Section 10(b) of the Exchange Act, or Rule 10b-5 thereunder.[24] Non-U.S. broker-dealers would also not be exempt from Exchange Act Sections 15(b)(4) and 15(b)(6), which give the SEC the authority to sanction broker-dealers and persons associated with broker-dealers.

Questions regarding this advisory should be addressed to **Guy P. Lander** (212-238-8619, lander@clm.com) or **Morris N. Simkin** (212-238-8708, simkin@clm.com).

[24] The proposed rule also would not affect any obligations a non-U.S. broker-dealer may have under any other law, including the Securities Act.

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