Cross-Border Securities Activities Under SEC Rule 15a-6

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Jurisdictional Issues

- The U.S. securities laws apply to broker-dealer activities in interstate commerce.
  - The term "interstate commerce" means trade, commerce, transportation, or communication among the several States, *or between any foreign country and any State*, or between any State and any place or ship outside thereof…"

- Accordingly, the U.S. securities laws apply to foreign broker-dealers doing business in the United States.

Broker-Dealer Registration

- Section 15(a) of the U.S. Securities Exchange Act of 1934 (the "Exchange Act") generally requires registration of foreign broker-dealers doing business with U.S. persons in the United States.
  - Section 15(a) requires a broker-dealer that uses the mails or any means of interstate commerce (the "jurisdictional means") to effect transactions in or to induce or attempt to induce the purchase or sale of any security to register with the U.S. Securities and Exchange Commission ("SEC" or the "Commission").
  - The definitions of "broker" and "dealer" under Sections 3(a)(4) and 3(a)(5) of the Exchange Act do not refer to nationality and include both domestic and foreign persons.
  - Under Rule 15a-6(b)(3), foreign broker-dealers are persons who are not resident in the United States, and not offices or branches of, or natural persons associated with, registered broker-dealers whose securities activities, if conducted in the United States, would fall within the definitions of broker or dealer.

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Broker-Dealer Registration

  - Any use of the U.S. jurisdictional means to engage in broker or dealer activities could trigger the broker-dealer registration requirements under Section 15(a).
- The SEC takes a territorial approach to the application of the U.S. securities laws.
  - Broker-dealers located outside the U.S. that solicit or effect transactions with persons in the U.S. are required to be registered.
  - Broker-dealers that solicit or effect transactions with U.S. or non-U.S. persons from within the territorial United States are required to be registered.
- Also, the SEC uses an entity approach to registered broker-dealers.
  - If a foreign broker-dealer operates a branch in the United States and thus becomes subject to U.S. broker-dealer registration, the registration requirements would apply to the entire foreign broker-dealer entity.

Broker-Dealer Registration

- But if the foreign broker-dealer establishes an affiliate in the United States, only the affiliate, and not the foreign broker-dealer parent, has to register.
- Under this arrangement, absent exemptions, only the registered U.S. affiliate may conduct broker-dealer activities with persons in the United States.
- However, the foreign broker-dealer may engage in certain activities involving U.S. Investors under the exemptive provisions of SEC Rule 15a-6.

Rule 15a-6 Exemptive Relief for Dealings with Investors in the United States

- Rule 15a-6 under the Exchange Act was adopted by the SEC in 1989 to clarify the circumstances in which a foreign broker-dealer may interact with U.S. investors without having to register with the SEC.
- The Rule provides exemptions from broker-dealer registration for, among other things, nondirect contacts by foreign broker-dealers with U.S. investors through execution of unsolicited transactions and the provision of research to major U.S. institutional investors, and direct contacts with U.S. institutional investors and major U.S. institutional investors through a U.S. registered broker-dealer intermediary.
- Some of the provisions of the Rule have been clarified (and, in effect, liberalized) through the issuance of no-action letters by the Commission staff.

Rule 15a-6: Definitions

- "U.S. institutional investor" means a registered investment company; a bank, savings and loan association, insurance company, business development company, small business investment company, or employee benefit plan defined in Rule 501(a)(1) of Regulation D under the 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).
- "Major U.S. institutional investor" means a U.S. institutional investor with assets, or assets under management, in excess of US$100 million, or a registered investment adviser with assets under management in excess of US$100 million.

Rule 15a-6: Definitions (cont'd)

- Pursuant to SEC no-action relief, the definition of major U.S. institutional investor has been expanded to include *any entity* that owns or controls (or, in the case of an investment adviser, has under management) financial assets in excess of US$100 million ("$100 Million Entities"). Financial assets include securities of unaffiliated issuers, cash, money market instruments, futures and other derivative instruments.
- Also pursuant to SEC no-action relief, in a private placement of equity securities in connection with mergers and acquisitions that could result in a transfer of control of a company or business unit, the term major U.S. institutional investor includes customers with $100 million in total assets, including assets that are not financial assets.

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Rule 15a-6: Nondirect Contacts with U.S. Investors

- Unsolicited Securities Transactions
  - The Commission does not believe that registration is necessary if U.S. investors have sought out foreign broker-dealers outside the United States and initiated foreign securities transactions in foreign securities markets entirely of their own accord.
  - Thus, paragraph (a)(1) of the Rule exempts from registration a foreign broker-dealer that effects securities transactions with or for persons it has not solicited.
  - However, the Commission views solicitation broadly as including any affirmative effort to induce transactional business for the broker-dealer or its affiliates. Solicitation includes efforts to induce a single transaction or to develop an ongoing securities business relationship.
- Provision of Research to Major U.S. Institutional Investors
  - The Commission believes that the provision of research to investors may constitute solicitation.
  - However, paragraph (a)(2) of the Rule provides an exemption from registration for foreign broker-dealers that furnish research reports, directly or indirectly, to major U.S. institutional investors under certain conditions.

Rule 15a-6: Nondirect Contacts with U.S. Investors (cont'd)

- Provision of Research to Major U.S. Institutional Investors (cont'd)
  - The research report must not recommend the use of the foreign broker-dealer to effect trades in any security.
  - Also, the foreign broker-dealer must not initiate contact to follow-up on the research reports, or otherwise attempt to induce securities transactions by those investors, except in accordance with the direct contact exemption contained in paragraph (a)(3) of the Rule.
  - The foreign broker-dealer also may not provide research pursuant to any express or implied understanding that the major U.S. institutional investors receiving the research will direct commission income to the foreign broker-dealer (i.e., no soft dollar arrangements).
  - If the above conditions are met, the foreign broker-dealer may effect trades in securities discussed in the research or other securities at the request of major U.S. institutional investors receiving the report.
  - If, however, the foreign broker-dealer has a "chaperoning" relationship with an SEC registered broker-dealer, under paragraph (a)(3), all resulting trades must be effected through that registered broker-dealer pursuant to the provisions of paragraph (a)(3).

Rule 15a-6: Nondirect Contacts with U.S. Investors (cont'd)

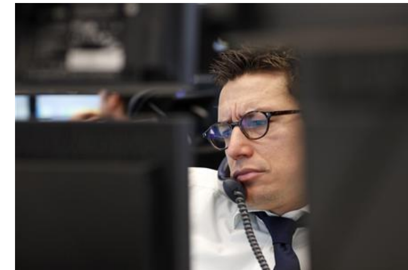
- Provision of Research to other U.S. Investors
  - As noted above, the exemption contained in paragraph (a)(2) applies only to the provision of research reports to major U.S. institutional investors.
  - However, foreign broker-dealers may distribute research to *any* U.S. investor provided that (i) a U.S. registered broker-dealer accepts responsibility for its content; (ii) the research report prominently indicates that any U.S. persons wishing to effect transactions in the securities discussed in the research do so through the registered broker-dealer; and (iii) all resulting transactions are effected by the registered broker-dealer.

Rule 15a-6: Contacts with U.S. Investors - Chaperoned and Unchaperoned Communications

- As originally adopted, Rule 15a-6(a)(3) provided that an associated person of a foreign broker-dealer (a "foreign associated person") could visit a U.S. institutional investor or major U.S. institutional investor in the United States if the visit was *chaperoned* by a U.S. registered broker-dealer that accepted responsibility for the foreign associated person's communications, and the U.S. registered broker-dealer participated in all other oral communications between the foreign associated person and a U.S. institutional investor, other than a major U.S. institutional investor.

Rule 15a-6: Contacts with U.S. Investors - Chaperoned and Unchaperoned Communications

- Under SEC no-action relief (the 1997 "Nine Firms Letter"), a foreign associated person may have in-person, *unchaperoned* contacts during visits to the United States with major U.S. institutional investors so long as the number of days on which such contacts occur does not exceed 30 per year and the Foreign Associated Person does not accept orders while in the U.S. to effect securities transactions.
  - Although not expressly stated in the relief, the SEC staff has said that the 30-day limit is per foreign associated person - *not* per firm.
- In addition, a foreign associated person may engage in oral communications with a U.S. institutional investor or major U.S. institutional investor without the participation of a U.S. registered broker-dealer if the call takes place outside of New York Stock Exchange ("NYSE") trading hours; and may accept orders in foreign securities during such calls.



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Rule 15a-6: Responsibilities of U.S. Broker-Dealer

- Rule 15a-6(a)(3) permits a foreign broker-dealer to induce or attempt to induce securities transactions by U.S. institutional investors or major U.S. institutional investors if, among other things, the foreign broker-dealer effects any resulting transactions through a U.S. registered broker-dealer in the manner prescribed by the Rule.
- Under the Rule, the registered broker-dealer must:
  - effect all aspects of the transaction (other than negotiation of the terms, which may occur between the investors and the foreign broker-dealer (through its sales personnel)), although the registered broker-dealer may delegate to the foreign broker-dealer the physical execution of foreign securities trades in foreign markets or on foreign exchanges;
  - issue confirmations and statements to customers;
  - extend margin or arrange for credit where necessary; receive, deliver and safeguard customer funds and securities;
  - comply with applicable U.S. net capital and recordkeeping requirements; and
  - maintain, in an office of the registered broker-dealer located in the U.S., books and records relating to the transactions.

Rule 15a-6: Additional Responsibilities of U.S. Broker-Dealer, Foreign Broker-Dealer and Foreign Associated Persons

- The U.S. registered broker-dealer must conduct due diligence on the background and disciplinary history of each foreign associated person, and, in particular, must determine that he or she is not subject to a statutory disqualification or certain substantially equivalent foreign disciplinary actions.
- The foreign broker-dealer and each foreign associated person must provide the U.S. registered broker-dealer with a written consent to service of process for any civil action brought by, or proceeding before, the Commission or a self-regulatory organization.

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Investment Banking Transactions Under Rule 15a-6

- Investment banking transactions, including:
  - financial advisory services provided in connection with cross-border mergers and acquisitions; and
  - overseas offerings under Regulation S

  should be performed in accordance with requirements of Rule 15a-6(a)(3), regarding contacts with issuers and investors and effectuation of transactions by the U.S. broker-dealer.

- M&A Transactions
  - For M&A transactions where a foreign broker-dealer is advising a non-U.S. client, it may contact buyers or sellers in the United States, or the U.S. parent of a non-U.S. buyer or seller (the "U.S. Target"), provided the U.S. Target qualifies as a major U.S. institutional investor.

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Investment Banking Transactions Under Rule 15a-6 (cont'd)

- M&A Transactions (cont'd)
  - The foreign broker-dealer may also develop and manage the data room and information process, conduct negotiations on behalf of the non-U.S. client and advise the non-U.S. client on the terms of the transaction.
  - Only foreign associated persons who have provided the U.S. broker-dealer with the required background information and consent to service of process may engage in contacts with the U.S. Target in the United States.
  - The foreign broker-dealer should not represent or advise any U.S. Target or receive, acquire or hold funds and securities in connection with a transaction it engages in with a U.S. Target.

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Investment Banking Transactions Under Rule 15a-6 (cont'd)

- Relief for Foreign Underwriters and Sellers
  - If a foreign broker-dealer, participating as an underwriter in a distribution of U.S. securities being made abroad, or being made both abroad and in the United States, limits its activities to:

    (i) taking down securities which it sells outside the United States to person other than U.S. nationals; and

    (ii) participating solely through its membership in the underwriting syndicate in activities of the syndicate in the United States such as sales to selling group members, stabilizing, overallotment, and group sales, which activities are carried out for the syndicate by a managing underwriter or underwriters who are U.S. registered, then the SEC will generally raise no objection if the foreign broker-dealer performs these limited functions without registration as a broker-dealer under the Exchange Act.

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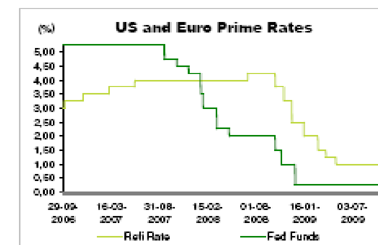
Activities With Selected Counterparties

- Under Rule 15a-6(a)(4), a foreign broker-dealer may solicit or conduct securities transactions with certain categories of counterparties without registering as a U.S. broker-dealer and without the intermediation of a chaperoning broker-dealer. These counterparties are SEC registered broker-dealers, banks acting in a broker-dealer capacity, certain supranational organizations, certain foreign persons temporarily visiting the United States and U.S. persons resident outside the United States.

Distribution of Research

- FINRA Rules 2241 and 2242, which govern the conduct of research analysts and the content of equity and debt research reports, respectively, apply to all research distributed by a FINRA member firm, including research prepared by a foreign broker-dealer under Rule 15a-6.
- Research reports prepared by a foreign broker-dealer and distributed by a U.S. broker-dealer are deemed to be third party research reports, as reports produced by a person other than a FINRA member.
- Prior to distributing any third party research, a U.S. broker-dealer must assure that such report contains the required disclosures under FINRA Rule 2241(h) or 2242(g)(3), as applicable.



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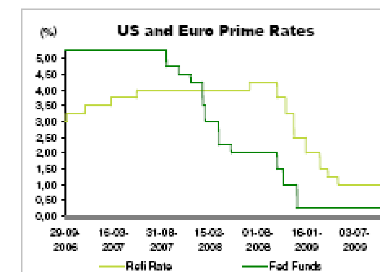
Distribution of Research (cont'd)

- The U.S. broker-dealer must accompany any third party research report it distributes with, or provide a web address that directs a recipient to, disclosure of any material conflict of interest that can reasonably be expected to have influenced the choice of a third-party research report provider or the subject company of a third-party research.
- Third party research must clearly be labeled as such.
- Some disclosures required under Rules 2241 and 2242 relate only to the U.S. broker-dealer, while others encompass the U.S. broker-dealer and its affiliates.



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Rule 2241 – Required Disclosures For Equity Research Reports

The U.S. broker-dealer must disclose in equity research reports it distributes which are prepared by a foreign broker-dealer affiliate:

- whether the U.S. broker-dealer or an affiliate managed or co-managed a public offering of securities for the subject company in the past 12 months, received compensation for investment banking services from the subject company in the past 12 months, or expects to receive or intends to seek compensation for investment banking services from the subject company in the next 3 months;
- whether the U.S. broker-dealer or its affiliates beneficially own 1% or more of any class of common equity securities of the subject company;
- whether the U.S. broker-dealer is a market maker in the subject company's securities; and
- whether there are any other material conflicts of interest of the research analyst or the U.S. broker-dealer that the analyst or an associated person of the U.S. broker-dealer with the ability to influence the content of a research report knows or has reason to know at the time of the publication or distribution of a research report.

Rule 2242 – Required Disclosures For Debt Research Reports

The U.S. broker-dealer must disclose in any debt research reports it distributes which are prepared by a foreign broker-dealer affiliate:

- whether the U.S. broker-dealer or an affiliate: (i) managed or co-managed a public offering of securities for the subject company in the past 12 months; (ii) received compensation for investment banking services from the subject company in the past 12 months; or (iii) expects to receive or intends to seek compensation for investment banking services from the subject company in the next three months.
- if the U.S. broker-dealer trades or may trade as principal in the debt securities (or in related derivatives) that are the subject of the debt research report.
- any other material conflict of interest of the debt research analyst or the U.S. broker-dealer that the debt research analyst or an associated person of the U.S. broker-dealer with the ability to influence the content of a debt research report knows or has reason to know at the time of the publication or distribution of a debt research report.

Rule 2242 – Institutional Exemption For Debt Research Reports

- FINRA Rule 2242 exempts debt research distributed to institutional investors from many of the rule's disclosure requirements, although a "health warning" is required.
- For purposes of the Rule, either of the following is an institutional investor:
  - Qualified Institutional Buyers ("QIBs") that affirmatively indicate that they are exercising independent judgment in evaluating the firm's recommendations. For QIBs from whom the firm has received a QIB certificate pursuant to FINRA Rule 2111 that covers fixed-income securities, no affirmative consent is required on the part of the investor.

Rule 2242 – Institutional Exemption For Debt Research Reports (cont'd)

- Other "institutional accounts" (as defined in FINRA Rule 4512(c)) that also affirmatively indicate that they wish to receive institutional fixed-income research and forego treatment as a retail investor for purposes of Rule 2242.

- Even if the U.S. broker-dealer can rely on this exemption, it may not distribute third party debt research if it knows or has reason to know such research is not objective or reliable; it must ensure any such report contains no untrue statement of a material fact and is otherwise not false or misleading; and it must ensure that each third party debt research report is clearly labeled as such.

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Independent Third Party Research Reports

- The disclosures regarding third party research reports do not apply to *independent* third party research reports made available by a U.S. broker-dealer to its customers. FINRA Rules 2241(a)(3) and 2242(a)(6) define an independent third party research report to mean a third party research report in respect of which the person producing the report (i) has no affiliation or business or contractual relationship with the distributing member or that member's affiliates that is reasonably likely to inform the content of its research reports; and (ii) makes content determinations without any input from the distributing member or that member's affiliates.

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- A U.S. broker-dealer has no supervisory responsibility for research reports furnished directly by a foreign broker-dealer to major U.S. Institutional Investors.
- However, if a U.S. broker-dealer distributes research prepared by a foreign broker-dealer, it has the following supervisory responsibilities:
  - For equity research reports, a registered principal (Series 24) or supervisory analyst (Series 16) must review for compliance with the applicable provisions of Rule 2241(h) and approve, by signature or initial, third party equity research reports.
  - For both equity and debt research reports, a registered principal or supervisory analyst must review and approve the reports to determine that the content of the research report contains no untrue statement of material fact or is otherwise not false or misleading.

Globally Branded and Mixed Team Research

- The determination of whether a research report is considered a product of the U.S. broker-dealer or of a third party depends on: (i) whether the report appears to be the product of the U.S. broker-dealer; and (ii) whether a research analyst associated with the U.S. broker-dealer is involved in producing the research report.
- It is irrelevant to the analysis where a report is distributed — domestically or internationally — or to whom it is distributed, or on which market the subject company's securities are traded.

Globally Branded and Mixed Team Research (cont’d)

- A research report that refers to the use of a single marketing identity that encompasses the U.S. broker-dealer and the foreign broker-dealer would be deemed to be “globally branded.”
- If a research report is globally branded, the U.S. broker-dealer must comply with all of the FINRA rules relating to equity or debt research reports, as applicable, not just third party research requirements.
- A research report prepared by a "mixed-team" that includes at least one person who meets the definition of research analyst associated with the U.S. broker-dealer also would be considered a report produced by the U.S. broker-dealer.

Regulation AC Disclosures

- Regulation AC under the Exchange Act also applies to foreign research distributed by a U.S. broker-dealer.
- Regulation AC requires that the research report include a certification by the analyst that the views expressed in the research accurately reflect his or her personal views.
- The analyst must also certify that no part of his or her compensation is tied to the recommendations or views expressed in the research. Otherwise, disclosure must be made as to the nature, source and amount of the compensation, and that such compensation could influence the views expressed in the research report.

Anti-Fraud Provisions of the Securities Laws

- Notwithstanding any exemption from the U.S. broker-dealer registration requirements, foreign broker-dealers remain subject to the anti-fraud provisions of the federal securities laws.