SEC Comment Letter on Proposed Amendments to Rule 15a-6

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Nancy M. Morris, Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-0609

Re: Proposed Amendments to Rule 15a-6; File No. S7-16-08

Dear Ms. Morris:

We appreciate this opportunity on behalf of our clients, including the firms identified below (the "Firms"), to comment on the proposed amendments to rule 15a-6 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), which provides an exemption from registration with the Securities and Exchange Commission ("SEC" or the "Commission") for foreign broker-dealers that conduct limited activities in the United States.[1] The Firms are all non-U.S. securities dealers currently doing business in the United States pursuant to rule 15a-6 through the intermediation of an affiliated U.S. registered broker-dealer established primarily for that purpose or through an unaffiliated U.S. registered broker-dealer engaged to provide such services.

The proposed amendments are intended to improve U.S. investors' access to foreign markets. Although the original rule, adopted in 1989, was a great advance in furthering cross-boarder trading, it has long been viewed by industry participants as unnecessarily restrictive and overly cumbersome, limiting U.S. investors' direct dealings with foreign broker-dealers and increasing the cost of investing in foreign securities. The SEC proposes to address these concerns by widening the scope of the exemption in most instances and facilitating compliance with the rule. In particular, the proposed amendments would expand the base of U.S. investors with which unregistered foreign broker-dealers could do business and reduce the extent of intermediation required by a U.S. registered broker-dealer.

[1] The proposed amendments were published for comment on June 27, 2008, in Exchange Act Release No. 58047. 73 Fed. Reg. 39182 (July 8, 2008) (the "Proposing Release"). Citations to the Proposing Release hereinafter will refer to the Federal Register.

Kathy H. Rocklen
212.969.3755 — krocklen@proskauer.com

Benjamin J. Catalano
212.969.3980 — bcatalano@proskauer.com

We agree with the Commission's objectives in this regard. However, we believe that certain aspects of the proposal would have the unintended effect of narrowing the exemption while others would retain unnecessary restrictions and add undue complexity to the rule.

Specifically, we respectfully suggest that the proposed rule should be amended as follows:

Eligible Investors: The proposed category of U.S. investors with whom foreign broker-dealers would be permitted to distribute research, solicit and effect transactions should be expanded to include investment advisers with assets under management of $25 million or more.

Intermediation: There should be no U.S. registered broker-dealer intermediation requirements for foreign broker-dealers that conduct a foreign business, and the proposed requirements should be replaced by undertakings by the foreign broker-dealer directly with the Commission.

Foreign Business: The foreign business test should be simplified by changing the definition of "foreign security" to make reference to "foreign issuer" instead of "foreign private issuer," or by referring to the issuer's status as a reporting company in the United States.

Interpretation Permitting the Distribution of Research to Non-Qualified Investors: The continued application of interpretative relief permitting foreign broker-dealers to distribute research reports to any U.S. person through a U.S. registered broker-dealer that accepts responsibility for the contents of the research should be confirmed.

I. THE CURRENT RULE 15a-6 EXEMPTION AND ITS LIMITATIONS

Rule 15a-6 currently provides a registration exemption for four kinds of activities by a foreign broker-dealer: (1) unsolicited transactions, (2) research (and related transactions), (3) solicitation and (4) unrestricted dealings with select investors.

The unsolicited transaction exemption contained in paragraph (a)(1) of rule 15a-6 permits a foreign broker-dealer to effect securities transactions for or with U.S. persons if the trades are not initiated by the foreign broker-dealer.[2]

The research exemption in paragraph (a)(2) of the rule permits foreign broker-dealers to distribute research reports to "major U.S. institutional investors"[3] and to effect transactions in the

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[2] The SEC defines "solicitation" to mean any affirmative conduct to induce transactional business, including, among other things, making phone calls to investors to discuss securities, distributing research to investors, advertising in the U.S. or maintaining an internet website accessible from the United States. Proposing Release at 39183.

[3] Rule 15a-6(b)(4) defines "major U.S. institutional investor" to mean:

> A person that is:
>
> (i) A U.S. institutional investor that has, or has under management, total assets in excess of $100 million; provided, however, that for purposes of determining the total assets of an investment company under this rule, the investment company may include the assets of any family of investment companies of which it is a part; or

securities discussed in the reports. The research reports cannot recommend use of the foreign broker-dealer to effect trades and the foreign broker-dealer may not contact the institutions to follow up on the research. (The initial distribution of the research is effectively the only form of solicitation permitted under this provision.) And, while the foreign broker-dealer may effect transactions in covered securities by the recipients of the research, if it has a relationship with a U.S. registered broker-dealer for the purpose of facilitating more expansive contacts under paragraph (a)(3) of the rule, the trades must be effected by that registered broker-dealer.

The solicitation exemption in paragraph (a)(3) permits foreign broker-dealers to induce (but not to effect) transactions in securities by "U.S. institutional investors"[4] or major U.S. institutional investors, provided that the foreign broker-dealer (1) effects any resulting trades through a U.S. registered broker-dealer that, among other things, (a) is responsible for issuing confirmations and statements to customers, extending margin or arranging for credit where necessary, receiving, delivering and safeguarding customer funds and securities, and complying with applicable U.S. net capital and recordkeeping requirements, (b) chaperones oral communications with U.S. institutional investors, (c) obtains certain biographical and disciplinary information and consents to service of process with respect to each associated person of the foreign broker-dealer that solicits U.S. investors ("foreign associated person") and (d) maintains records with respect to the foreign associated persons and transactions by the U.S. investors and (2) agrees to provide information, documents and testimony about the transactions to the SEC upon request. All foreign associated persons must conduct their activities from outside the U.S. (except for visits that are chaperoned by the U.S. registered broker-dealer and limited unchaperoned visits with major institutional investors) and may not, in the determination of the U.S. registered broker-dealer intermediating the transactions, be subject to certain disqualifications.

The exemption contained in paragraph (a)(4) permits foreign broker-dealers to solicit and effect transactions in securities by a U.S. registered broker-dealer or a bank (operating under an exception or exemption from registration as a broker-dealer), specified international organizations, foreign persons temporarily present in the U.S. and U.S. persons located abroad.

(ii) An investment adviser registered with the Commission under section 203 of the Investment Advisers Act of 1940 that has total assets under management in excess of $100 million.

The Commission staff expanded the definition to include any entity with assets under management in excess of $100 million. *See* Letter from Catherine McGuire, Chief Counsel, Division of Market Regulation, to Giovanni Prezioso, Cleary Gottlieb, Steen & Hamilton, 1997 WL 219905 (publicly available Apr. 28, 1997).

[4] Rule 15a-6(b)(7) defines "U.S. institutional investor" to mean:

(i) An investment company registered with the Commission under section 8 of the Investment Company Act of 1940; or
(ii) 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 of 1933 (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).

The unsolicited transaction exemption in paragraph (a)(1) is of scant utility because the SEC defines solicitation so broadly as to prevent foreign broker-dealers from making their services known in the United States. And the limited categories of investors that foreign broker-dealers may deal with on an unrestricted basis under paragraph (a)(4) also make this exemption of minimal use to ordinary U.S. investors looking to trade abroad.

The research exemption in paragraph (a)(2) provides some motivation for foreign broker-dealers to enter the United States market on a limited basis; however, the category of investors to whom the foreign broker-dealer may send research is limited to institutions with more than $100 million of invested assets and its ability to effect any resulting trades is significantly impaired by the prohibition on recommending use of the firm and the restriction on follow up contacts. Use of the broader solicitation exemption in paragraph (a)(3) is similarly constrained by the limited range of institutional investors to which it pertains. Meanwhile, the restriction on effecting securities transactions through a U.S. registered broker-dealer has limited U.S. investors' access to numerous foreign broker-dealers unwilling to incur the substantial cost of establishing a relationship with a U.S. registered broker-dealer and raised the cost of investing in foreign securities through those that have.

II. THE PROPOSED AMENDMENTS

The SEC's proposal would increase U.S. investors' access to foreign markets by expanding the scope of the research and solicitation exemptions under rule 15a-6(a)(2) and (3) to encourage greater participation by foreign broker-dealers.

Specifically, the proposed amendments would replace the definitions of U.S. institutional investor and major U.S. institutional investor for purposes of both exemptions with the definition "qualified investor," a term already defined under the Exchange Act.[5] The principal differences

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[5] *See* proposed rule 15a-6(a)(2) and (3). Section 3(a)(54)(A) of the Exchange Act defines the term "qualified investor" to mean:

> (i) any company registered with the Commission under section 8 of the Investment Company Act of 1940 (the "Investment Company Act");
> (ii) any issuer eligible for an exclusion from the definition of investment company pursuant to section 3(c)(7) of the Investment Company Act;
> (iii) any bank (as defined in section 3(a)(6) of the Exchange Act), savings association (as defined in section 3(b) of the Federal Deposit Insurance Act), broker, dealer, insurance company (as defined in section 2(a)(13) of the Securities Act), or business development company (as defined in section 2(a)(48) of the Investment Company Act);
> (iv) any small business investment company licensed by the United States Small Business Administration under section 301(c) or (d) of the Small Business Investment Act of 1958;
> (v) any State sponsored employee benefit plan, or any other employee benefit plan, within meaning of the Employee Retirement Income Security Act of 1974, other than individual retirement account, if the investment decisions are made by a plan fiduciary, as defined in section 3(21) of the Act, 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 (as defined in section 1(b)(7) of the International Banking Act of 1978);
> (x) the government of any foreign country;

in the proposed category are the reduced threshold of invested assets in relation to major U.S. institutional investors – lowered to $25 million from $100 million – and the inclusion of natural persons meeting the invested asset requirement.

In addition, the proposed amendments to the solicitation exemption would eliminate the chaperoning requirements for direct communications with qualified investors,[6] visits with those investors in the U.S. would be permitted up to 180 days[7] and the foreign broker-dealer would be permitted to perform most, if not all, of the brokerage activities currently required to be performed by a U.S. registered broker-dealer pursuant to rule 15a-6(a)(3)(iii)(A).[8]

In a change from the existing rule, a foreign broker-dealer operating under this exemption would have to be regulated in its home country for conducting securities activities, including the specific activities performed for qualified investors.[9] Moreover, the foreign broker-dealer would be required to disclose to qualified investors that it is regulated by a foreign securities authority and not by the SEC and, where the foreign broker-dealer is holding U.S. investors' assets, that U.S. segregation requirements, bankruptcy laws and SIPA protections do not apply.[10] The foreign broker-dealer – not the U.S. registered broker-dealer – would have to determine that its foreign associated persons dealing with qualified investors are not the subject of any statutory disqualification or other specified offenses and maintain biographical and disciplinary information about those associated persons.[11]

However, the amended rule still would require the intermediation of a U.S. registered broker-dealer to maintain books and records relating to transactions with U.S. persons and, depending on the extent of the foreign broker-dealer's business in U.S. securities, handling and safeguarding customer funds and securities.[12] Under "Exemption (A)(1)," a foreign broker-

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(xi) any corporation, company, or partnership that owns and invests on a discretionary basis not less than $25,000,000 in investments;
(xii) any natural person who owns and invests on a discretionary basis not less than $25,000,000 in investments;
(xiii) any government or political subdivision, agency, or instrumentality of a government that owns and invests on a discretionary basis not less than $50,000,000 in investments; or
(xiv) any multinational or supranational entity or any agency or instrumentality thereof.

The securities lending provisions under the bank "push out" rules of Regulation R permit banks to engage in certain securities lending activities with qualified investors without coming within the definition of "broker" or "dealer" under section (3)(a)(4) and (5) of the Exchange Act. *See* rule 772 of Regulation R; *see also* rule 15a-11(a)(1) under the Exchange Act.

6 *Compare* current rule 15a-6(a)(3)(iii)(B) *with* proposed rule 15a-6(a)(3)(iii); *compare* current rule 15a-6(a)(3)(ii)(A)(1) *with* proposed rule 15a-6(a)(3)(ii).

7 *See* Proposing Release at 39194.

8 *Compare* current rule 15a-6(a)(3)(iii)(A) *with* proposed rule 15a-6(a)(3)(iii)(A)(1) and (2).

9 *See* proposed rule 15a-6(b)(2)(i).

10 *See* proposed rule 15a-6(a)(3)(i)(D).

11 *See* proposed rule 15a-6(a)(3)(i)(B) and (C)

12 *See* proposed rule 15a-6(a)(3)(iii)(A)(1) and (2).

dealer that conducts a "foreign business" would be able to perform what amounts to full service brokerage for qualified investors.[13] Copies of all books and records relating to the transactions nevertheless would have to be maintained by a U.S. registered broker-dealer.[14] Under "Exemption (A)(2)," a foreign broker-dealer that does not meet the foreign business test could conduct all securities activities contemplated by Exemption (A)(1) other than handling customer assets.[15] The foreign broker-dealer would be required to use a U.S. registered broker-dealer to maintain books and records related to transactions by qualified investors and to receive, deliver and custody funds and securities in connection with the trades.[16]

Finally, the proposed amendments would add U.S. resident fiduciaries of "foreign resident clients" to the existing categories of investors with whom a foreign broker-dealer could do an unrestricted business under the exemption contained in rule 15a-6(a)(4).[17]

III. COMMENTS AND SUGGESTED CHANGES TO THE PROPOSED AMENDMENTS

The current version of rule 15a-6 was initially proposed in 1988 in response to the growing internationalization of the securities markets.[18]

> Specifically, the Commission sought to facilitate investment by U.S. institutional investors in foreign securities markets by proposing a rule that would increase access to foreign broker-dealers, consistent with the investor safeguards afforded by broker-dealer regulation.[19]

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[13] *See* proposed rule 15a-6(a)(3)(iii)(A)(1) and 15a-6(b)(3). Proposed rule 15a-6(b)(3) would define the term "foreign business" to mean:

> The business of a foreign broker or dealer with qualified investors and foreign resident clients where at least 85% of the aggregate value of the securities purchased or sold in transaction conducted pursuant to both paragraphs (a)(3) and (a)(4)(vi) of [rule 15a-6] by the foreign broker or dealer calculated on a rolling two-year basis is derived from transactions in foreign securities, except that the foreign broker or dealer may rely on the calculations made for the prior year for the first 60 days of the new year.

[14] *See* proposed rule 15a-6(a)(3)(iii)(A)(1). Under current rule 15a-6(a)(3)(iii)(A)(4), the U.S. registered broker-dealer effecting the transactions must maintain similar books and records in the United States in accordance with U.S. regulations.

[15] *See* proposed rule 15a-6(a)(3)(iii)(A)(2)

[16] *See* proposed rule 15a-6(a)(3)(iii)(A)(2)(i) and (ii).

[17] *See* proposed rule 15a-6(a)(4)(vi). Under proposed rule 15a-6(b)(4), a "foreign resident client" would be defined as: (1) any entity not organized or incorporated under the laws of the U.S. and not engaged in a trade or business in the U.S. for federal income tax purposes; (2) any natural person not a resident for federal income tax purposes; and (3) any entity not organized or incorporated under U.S. law, 85 percent or more of whose outstanding voting securities are beneficially owned by the persons described in (1) or (2). The exemption with respect to U.S. fiduciaries of foreign resident clients would be available only if the foreign broker-dealer is conducting a foreign business as described above. *See* proposed rule 15a-6 (b)(2)(ii).

[18] *See* 54 Fed. Reg. 30013 (July 13, 1989) (hereinafter "1989 Adopting Release").

[19] *See* 1989 Adopting Release at 30014.

The current rule accomplishes this objective by permitting foreign broker-dealers to engage in limited research and solicitation activities with U.S. institutions in conjunction with a U.S. registered broker-dealer that performs three primary functions: (1) conducts due diligence on the background and disciplinary histories of the foreign broker-dealer and its foreign associated persons, (2) participates in communications with U.S. investors and, in most instances, effectuates any resulting transactions and (3) maintains books and records related to those functions. Now, in response to "ever increasing market globalization," the SEC proposes "to revisit that framework to consider whether it could be made more workable, consistent with the Commission's mission to protect investors, maintain fair, orderly and efficient markets and facilitate capital formation."[20]

The proposed amendments would encourage greater participation by foreign broker-dealers in the U.S. market principally by broadening the range of investors they could deal with and expanding the services they could provide without registration. With respect to the latter, a U.S. registered broker-dealer would no longer be required to participate in direct communications between the foreign broker-dealer and U.S. investors. Nor would it be required to effect any resulting transactions. Indeed, except in those instances in which the foreign broker-dealer is conducting a substantial business in U.S. securities, the U.S. registered broker-dealer would not be required to perform any traditional brokerage activities. In this regard, a greater reliance on the sophistication of investors with the requisite amount of investment experience, some comfort that the foreign broker-dealer is regulated overseas and notice that its activities are not subject to U.S. regulation would largely replace the overlay of Exchange Act regulation currently afforded by the accompaniment of a U.S. registered broker-dealer to solicit and effect transactions. The U.S. registered broker-dealer's role would be reduced essentially to acting as a surety for the production of books and records related to U.S. transactions and the performance of regulatory due diligence by the foreign broker-dealer.

We agree with the SEC's approach as the best means of assuring broader, more efficient and less expensive access to foreign markets for U.S. investors that are capable of evaluating and bearing the risk of trading in those markets. However, we believe that certain aspects of the proposal are inconsistent with this formula. In particular, the category of U.S. investors with whom foreign broker-dealers would be permitted to deal under the proposed amendments excludes investment advisers with the requisite assets under management – a crucial group of investors covered under the current rule. Moreover, the intermediation requirements for foreign broker-dealers conducting a foreign business are unnecessary to achieve any meaningful investor protection and should be eliminated as an unwarranted obstruction to foreign broker-dealer participation in U.S. markets. Similarly, the procedure for measuring compliance with the foreign business test is too difficult and should be simplified to refer to transactions in equity and debt securities of a foreign issuer or the issuer's U.S. reporting status – more definitive standards than foreign private issuer. Finally, the SEC should confirm the continued application of interpretive relief allowing foreign broker-dealers to distribute research to any U.S. investor through a U.S. registered broker-dealer that accepts responsibility for the content of the research

[20] Proposing Release at 39183.

and effects any resulting transactions as providing all of the necessary protections under the Exchange Act. The Commission also may wish to provide additional guidance on the application of U.S. and foreign law to the books and records maintenance requirement under Exemption (A)(2).

A. Qualified Investors

The SEC proposes to replace the terms "major U.S. institutional investor" and "U.S. institutional investor" with the term "qualified investor" for purposes of the research and solicitation exemptions under Rule 15a-6. In so doing, the Commission notes that the change

> . . . would *expand* the category of U.S. investors with which a foreign broker-dealer could interact under Rule 15a-6(a)(2) and would *expand, with few exceptions*, the category of U.S. investors with which a foreign broker-dealer could interact under Rule 15a-6(a)(3)[.][21]

However, the definition of major U.S. institutional investor – used alone in the research exemption and in combination with U.S. institutional investor in the solicitation exemption – expressly includes a U.S. registered investment adviser with assets under management in excess of $100 million and SEC staff interpretive relief has expanded it to include any institution, including an unregistered investment adviser, that meets this assets under management test.[22] The definition of qualified investor does not included a registered investment adviser.[23] And because the natural and non-natural person provisions apply only to individuals and entities that "*own[] **and** invest[]* on a discretionary basis not less than $25,000,000 in investments,"[24] the definition would exclude many, if not most, investment advisers, which ordinarily do not own the assets that they manage. Use of the term, therefore, would contract – not expand – the current category of eligible investors under paragraph (a)(2) and create a significant new exception to the group of investors under paragraph (a)(3).

Many foreign broker-dealers rely on the current definition to send research directly to registered and unregistered investment advisers under rule 15a-6(a)(2) and to engage in follow-up contacts with them under rule 15a-6(a)(3). The proposed amendment would prevent them from doing so in the future, and, on a practical basis, restrict access to research and information on foreign securities for mutual funds, pension plans, hedge funds and other accounts advised by professionals.[25] We do not believe that this is what the SEC has in mind by proposing to reduce the invested asset test. The test is meant to be a measure of *experience*

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[21] Proposing Release at 39185 (citations omitted) (emphasis supplied).

[22] *See supra* n.3.

[23] *See supra* n.5.

[24] *See* Exchange Act section 3(a)(54)(A)(xi) and (xii), *supra* n.5 (emphasis supplied).

[25] While many of these institutions would be qualified investors, their investment decisions are typically made by registered and unregistered investment advisers, the solicitation of which would be prohibited in most cases.

investing in securities sufficient to evaluate the risks in trading abroad.[26] Accordingly, investment discretion – not ownership – is the critical factor in determining investor competence for purposes of the exemptions.

Indeed, the omission of an assets under management alternative to ownership and investment appears to be unintentional.[27] In the Proposing Release, the SEC noted the following about the asset test in the definition of qualified investor:

> [T]he primary distinction between a major U.S. institutional investor and a qualified investor is the threshold value of assets or investments *owned* **or** *invested* and the inclusion of natural persons. As a result, under the proposed rule, the threshold would decline from institutional investors that own or control greater that $100 million in total assets to, among others . . . corporations, companies, or partnerships that *own* **or** *invest* on a discretionary basis $25 million or more in investments. In addition, under the proposed rule, natural persons who *own* **or** *invest* would be included.[28]

We, therefore, recommend that the definition of qualified investor be supplemented to include investment advisers with assets under management of not less than $25 million based on the likely knowledge and investment experience of that class of investors.

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[26] *See* Proposing Release at 39186 ("The Commission proposes to use the definition of 'qualified investor' in section 3(a)(54) of the Exchange Act for several reasons primarily related to the sophistication and likely experience with foreign securities and foreign markets of the investors included in the definition.").

Investment experience is the same consideration underlying the asset test in the definition of major U.S. institutional investor under the current rule, which explicitly recognizes that the relevant experience can reside with the investor's investment adviser. *Compare* 1989 Adopting Release at 30027 ("[T]he Commission continues to believe that institutions with [the major U.S. institutional investor] level of assets are more likely to have the skills and experience to assess independently the integrity and competence of the foreign broker-dealers providing . . . access [to foreign markets].") *with* the 1988 Proposing Release, 53 Fed. Reg. 23645, 23654 (June 14, 1988) ("The $100 million asset level . . . is designed to increase the likelihood that the institution *or its investment advisers* have prior experience in foreign markets that provides insight into the reliability and reputation of various foreign broker-dealers.") (emphasis supplied).

[27] By replacing the definitions of U.S. institutional investor and major U.S. institutional investor with qualified investor, the SEC would intentionally omit some investors presently covered by the research and solicitation exemptions from the group of investors that foreign broker-dealers could contact under the amended rule. Again, the basis for excluding these investors from the modified exemptions is investment experience, which it is thought would be deficient in relation to the investors specified in the definition of qualified investor.

> We believe that the proposed use of the definition of qualified investor would more accurately encompass persons that have prior experience in foreign markets and appropriate level of investment experience and sophistication overall. In certain instances, it would exclude persons that are currently included in the definition of U.S. institutional investor or major U.S. institutional investor. *In each such instance, the proposed use of the definition of qualified investor would require greater investment experience of the entity than the current definition.* Proposing Release at 39186 (emphasis supplied).

This, however, is not true of investment advisers with the requisite assets under management, who would likely have as much or more investment experience as any person that meets the definition of qualified investor notwithstanding that they do not own the assets that they manage.

[28] Proposing Release at 39186 (emphasis supplied).

B. Intermediation of Foreign Broker-Dealers Conducting a Foreign Business

The SEC proposes to amend the solicitation exemption in rule 15a-6(a)(3) to permit foreign broker-dealers conducting a foreign business to provide "full service brokerage" to qualified investors by soliciting, effecting, and financing securities transactions and holding customer funds and securities.[29] Consequently, a U.S. registered broker-dealer would not have to perform any of the brokerage activities specified in current rule 15a-6(a)(3)(iii)(A). However, some intermediation still would be required. Specifically, a U.S. registered broker-dealer would have to maintain books and records relating to transactions with qualified investors, which could be maintained with the foreign broker-dealer as prescribed by foreign law.[30] In addition, the U.S. registered broker-dealer would have to obtain consents to service of process from the foreign broker-dealer and each foreign associated person for civil regulatory proceedings[31] and a representation from the foreign broker-dealer of its compliance with the employee due diligence and related recordkeeping requirements.[32] Finally, it would have to maintain records of the consents to service of process and representation for production to the Commission on request.[33] According to the SEC, the proposed changes would

> . . . allow qualified investors the more direct contact they seek with those expert in foreign markets and foreign securities . . . [while] . . . retain[ing] important measures of investor protection that . . . would, among other things, address the potential risks to qualified investors related to contacts with foreign associated persons with a disciplinary history and ensure that the books and records related to transactions for U.S. investors are available to the Commission.[34]

We believe, however, that the requirement that these functions be performed by a U.S. registered broker-dealer would continue to place a substantial burden and related expense on foreign broker-dealers that would conduct business in the U.S. entirely through rule 15a-6, preventing U.S. investors from dealing with many such firms and increasing the cost of accessing foreign markets. At the same time, it would provide no significant investor protection that could not be obtained through similar undertakings by the foreign broker-dealer directly with the Commission.

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29 *See* Proposing Release at 39188.

30 *See* proposed rule 15a-6(a)(3)(iii)(A)(1).

31 *See* proposed rule 15a-6(a)(3)(iii)(B).

32 *See* proposed rule 15a-6(a)(3)(iii)(C).

33 *See* proposed rule 15a-6(a)(3)(iii)(D).

34 Proposing Release at 39188.

Currently, a foreign broker-dealer that wishes to do business in the United States under rule 15a-6 must establish an affiliated U.S. registered broker-dealer[35] or partner with an unaffiliated U.S. registered broker-dealer to intermediate contacts and effect trades pursuant to paragraph (a)(3)(iii).[36] Many foreign broker-dealers do not do business in the United States because of the substantial cost of registration and continued regulation or the diminished profit margins associated with partnering with another firm. Many foreign firms that have incurred the cost of registration have done so simply to do the limited business permitted under rule 15a-6. For those firms that cost is substantial: There are significant expenses for registration with the SEC and membership in a self-regulatory organization ("SRO"); licensing fees and examination requirements for associated persons; regulatory reporting requirements; compliance and supervisory systems; continuing education and other requirements, many of which may be duplicative of requirements in the foreign-broker-dealer's home country. There are also expenses associated with establishing and maintaining a separate entity, such as corporate organization, staffing and administration, books and records, financial accounting and auditing services and other overhead expenses.[37] While partnering with an unaffiliated U.S. registered broker-dealer may defray some of these costs, it also limits the profitability of the U.S. business. (Query whether it would even be possible under the amended rule once the U.S. registered broker-dealer is no longer required to effectuate transactions, thereby depriving it of its profit motive in providing the service.) In the past these expenses have been an obstacle to small and medium-size foreign broker-dealers' entry into the United States market – limiting U.S investors' access to numerous additional conduits to foreign markets; while those foreign firms that have entered the U.S. market no doubt have been compelled to pass on these expenses to U.S. investors, significantly increasing the cost of trading in foreign securities.

Under the proposed amendments to rule 15a-6(a)(3), the costs associated with having a U.S. registered broker-dealer intermediate transactions would no longer be justified – at least with regard to foreign broker-dealers conducting a foreign business – because the Exchange Act protections afforded by requiring a registered broker-dealer to effectuate the trades and handle customer funds and securities would be supplanted by foreign regulation and notice of the inapplicability of U.S. protections. Yet most of those costs would survive because of the requirement that *a U.S. registered broker-dealer* carry out the remaining intermediation functions pertaining to the maintenance of books and records, the obtaining of consents to service of process and the receipt of assurance about the performance of due diligence by the foreign broker-dealer. By themselves, these functions are not in the nature of brokerage services and, therefore, do not require the participation of a broker-dealer (registered or unregistered) to perform them. More importantly, however, no third party's performing them is likely to achieve

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[35] Because the U.S. securities laws would apply to a registered broker-dealer's activities with non-U.S. persons outside the United States, most foreign broker-dealers are reluctant to register themselves with the Commission, choosing, instead, to register a separate, affiliated entity whose operations are limited to the United States.

[36] *See* current rule 15a-6(a)(3)(iii).

[37] For the most part, only large U.S. securities firms with foreign operations and multi-national banks operating in the United States bear these costs in relation to a U.S. securities business beyond what is permitted under rule 15a-6.

any greater protection than would be obtained by an undertaking or commitment by the foreign broker-dealer with the SEC to perform them itself.

1. Maintenance of Books and Records

The proposed intermediation requirement in subparagraph (A)(1) of the solicitation exemption provides that a U.S. registered broker-dealer shall be responsible for:

> (1) Maintaining copies of all books and records, including confirmations and statements issued by the foreign broker or dealer to the qualified investor, relating to any resulting transactions, except that such books and records may be maintained:
>
> (i) In the form, manner and for the periods prescribed by the foreign securities authority regulating the foreign broker or dealer; and
>
> (ii) With the foreign broker or dealer, provided that the registered broker or dealer makes a reasonable determination that copies of any or all of such books and records can be furnished promptly to the Commission, and promptly provides to the Commission any such books and records, upon request.[38]

The SEC appreciates that permitting a foreign broker-dealer to effect transactions and maintain custody of assets for U.S. investors would necessarily result in the foreign broker-dealer creating and maintaining books and records related to such activities in accordance with the laws of its home country and that it may be unduly burdensome to require a U.S. registered broker-dealer to maintain copies of those books and records that conform to U.S. standards.[39] Similarly, the SEC would allow copies of the books and records to be kept with the foreign broker-dealer provided that the Commission obtains some assurance from the U.S. registered broker-dealer that they would be readily available to it on demand.[40] Those assurances would consist of the registered

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[38] Proposed rule 15a-6(a)(3)(iii)(A)(1).

[39] *See* Proposing Release at 39189.

[40] Indeed the purpose of the intermediation requirement in Exemption (A)(1) is to ensure the *availability* of the books and records to the SEC – not to establish the Commission's right to the documents.

> [T]he Commission believes that allowing U.S. registered broker-dealers to maintain books and records with a foreign broker-dealer would appropriately support the Commission's interest in the protection of investors – by being designed to ensure that the books and records related to transactions for U.S. investors are *available* to the Commission – while avoiding the burden that might be placed on U.S. registered broker-dealers under the exemption by requiring the books and records to be maintained in the form, manner and for the periods prescribed by Rules 17a-3 and 17a-4 under the Exchange Act, as if the U.S. registered broker-dealer had effected the transaction under proposed Exemption (A)(*1*). Proposing Release at 39189 (emphasis supplied).

A foreign broker-dealer operating in the United States pursuant to the exemption from registration under rule 15a-6 is, nevertheless, subject to U.S. jurisdiction and SEC enforcement of the federal securities laws applicable to unregistered broker-dealers and market participants in general, including the anti-fraud provisions of the federal securities laws – section 17(a) of the Securities Act and section 10(b) and rule 10b-5 under the Exchange Act. *See* 1989 Adopting Release at 30021; Proposing Release at 39199. In addition, section 21 of the Exchange Act permits the Commission to investigate and to compel testimony and the production of books and records from "any person" that "has violated, is violating, or is about to violate," among other things, the

broker-dealer (1) making a reasonable determination that copies of the books and records can be furnished promptly to the SEC and (2) producing such books and records to the Commission upon request.

While the relief in paragraphs (A)(1)(i) and (ii) is offered as an alternative to maintaining copies of the books and records in compliance with U.S. law with the U.S. registered broker-dealer, we expect that it is the only viable option given the impracticability of remaking those books and records to conform to U.S. standards and the intermediary's inability to ensure that it has *all* such documents in its possession.[41] Under the circumstances, the usefulness of the intermediation requirement would necessarily turn on the benefit in having a U.S. registered broker-dealer (or anyone else for that matter) make the requisite determination and production instead of the foreign broker-dealer. We suggest that it would, in fact, provide no greater assurance of availability and production of the documents.

The SEC said that in making a "reasonable determination" that copies of the books and records can be furnished promptly, it expects that the U.S. registered broker-dealer:

> would need to consider, among other things, the existence of any legal limitations in the foreign jurisdiction that might limit the ability of the foreign broker-dealer to disclose information relating to transactions conducted pursuant to proposed Exemption (A)(1) to the U.S. registered broker-dealer.[42]

The Commission's chief concern is that some of the books and records might not be made readily available because of information privacy laws or other restrictions imposed upon the

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Exchange Act and the rules promulgated thereunder, and to seek civil penalties and equitable relief in a civil enforcement action against any such person. Section 20 of the Securities Act provides similar recourse to the Commission with respect to violations of that statute and the rules promulgated thereunder.

The SEC's authority to invoke these provisions would extend to any foreign person or entity who has had the requisite "minimum contacts" with the U.S., including an unregistered broker-dealer or its associated persons operating under rule 15a-6. *See* Exchange Act section 27; *see also e.g., SEC v. Lines Overseas Mgmt., Ltd.*, No. Civ. A. 04-302, 2005 WL 3627141, at *2 (D.D.C. Jan. 7, 2005) (stating, in the context of finding personal jurisdiction over foreign investors, that section 27 of the Exchange Act allows the SEC to exercise personal jurisdiction to the limits of the Due Process Clause of the Fifth Amendment); *SEC v. Unifund SAL*, 910 F.2d 1028 (2d Cir. 1990) (finding personal jurisdiction over a foreign investment company alleged to have traded while in possession of material non-public information). Likewise, private plaintiffs can obtain personal jurisdiction over foreign persons and entities in suits under section 10(b) of the Exchange Act and rule 10b-5 thereunder. *See, e.g.*, *Cromer Finance Ltd. v. Berger*, 137 F. Supp. 2d 452 (S.D.N.Y. 2001) (finding personal jurisdiction over foreign administrators of an off-shore investment fund).

Moreover, proposed rule 15a-6(a)(3)(i)(A), which would not be changed in any material respect from the original contained in paragraph (a)(3)(i)(B) of the current rule, would require the foreign broker-dealer to provide to the Commission upon request (or pursuant to international agreements) with any information, documents or testimony of the foreign broker-dealer or its foreign associated persons, or assistance obtaining evidence from other persons, related to transactions under the solicitation exemption. *See* proposed rule 15a-6(a)(3)(i)(A). The provision also would provide for withdrawal of the exemption in paragraph (a)(3) in the event that the foreign broker-dealer is unable to comply with the SEC's request under the laws of the foreign country, preventing any continuing harm to investors.

[41] While the intermediary's failure to maintain possession of the relevant books and records would primarily affect the availability of the exemption to the foreign broker-dealer, the U.S. registered broker-dealer could be exposed to liability for aiding and abetting a registration violation by the foreign broker-dealer under sections 20(e) and 21B(a) of the Exchange Act.

[42] *See* Proposing Release at 39189.

foreign broker-dealer by foreign law. However, as between the U.S. registered broker-dealer and the foreign broker-dealer, the latter – more familiar with its own books and records and the laws of its home country – is in the best position to make this assessment.[43] Instead, a foreign broker-dealer that does not have an existing relationship with an affiliated or unaffiliated U.S. registered broker-dealer would have to establish one for this purpose; while a foreign broker-dealer that has such a relationship solely to facilitate U.S. business under rule 15a-6 would have to maintain it for the same reason. (Again, we wonder whether any U.S. registered broker-dealer unaffiliated with the foreign broker-dealer would be willing to undertake this obligation without the financial incentive that comes from performing the trades.)

The second component of this intermediation provision would require that the U.S. registered broker-dealer promptly provide the books and records to the Commission on request. However, since the relevant books and records would be physically located with the foreign broker-dealer, it is unlikely that the U.S. registrant would be able to produce the documents in the event that the foreign firm is unable or unwilling to make them available. Under such circumstances, it would be more effective for the SEC to make the demand of the foreign broker-dealer directly. As noted above, the SEC would have jurisdiction over the foreign broker-dealer (which would have used the means of interstate commerce to do business with U.S. persons) regardless of its registration status,[44] and the foreign broker-dealer would have to agree to provide all relevant information to the Commission as a condition of its reliance on the exemption. Indeed, we fail to see what practical value there could be in making a request for documents and obtaining production of them through a third party.[45] To obtain greater assurance, the SEC should obtain from the foreign broker-dealer an undertaking in writing to produce at the Commission's offices on demand copies of any or all books and records that it is required to make or has made in connection with any transaction with a U.S. person pursuant to rule 15a-6 similar to the undertaking currently made by a non-resident U.S. registered broker-dealer pursuant to rule 17a-7(b) under the Exchange Act to permit it to maintain books and records outside the United States.

2. Consents to Service of Process, Assurances of Compliance with Foreign Broker-Dealer Due Diligence Requirements and Related Recordkeeping Responsibilities

The remaining intermediation requirements – applicable to both Exemption (A)(1) and Exemption (A)(2) – would require a U.S. registered broker-dealer:

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[43] It may be that the SEC would prefer that this determination be made by another party. If so, a U.S. registered broker-dealer affiliated (or partnered) with the foreign broker-dealer to facilitate business under the exemption likely would not be any more objective in its assessment. In any event, the Commission would have sufficient recourse against the foreign broker-dealer for a determination made in bad faith. *See supra* n.40.

[44] *See supra* n.40.

[45] In the end, we believe that the Commission staff will be more likely to make such requests directly of the foreign broker-dealer, rendering this part of the intermediation requirement superfluous.

(1) to obtain written consent to service of process for civil proceedings brought by the SEC or a SRO from the foreign broker-dealer and each foreign associated person;[46]

(2) to obtain a representation from the foreign broker-dealer that it has complied with the due diligence requirements with respect to foreign associated persons as required by paragraph (a)(3)(i)(B) and has in its files and will make available to the U.S. registered broker-dealer the disciplinary histories and background information specified in paragraph (a)(3)(i)(C);[47] and

(3) to maintain records of the consents and representation of compliance with paragraphs (a)(3)(i)(B) and (C) for production to the Commission on request.[48]

The consents to service of process could just as readily be obtained by the Commission. Indeed, the SEC currently obtains consent to service of process on Form 8-M for civil actions or proceedings brought against non-resident registered broker-dealers based on the federal securities laws.[49] We suggest that a similar requirement by the foreign broker-dealer and its associates would be preferable to engaging the services of a U.S. registered broker-dealer for this limited purpose.[50]

In addition, we do not see any purpose in enlisting a U.S. registered broker-dealer (or anyone else) to obtain a representation of compliance with the foreign broker-dealer's due diligence and recordkeeping responsibilities with respect to foreign associated persons. Under the proposed amendments, the due diligence and related recordkeeping obligations – currently performed by a U.S. registered broker-dealer – would be performed by the foreign broker-dealer.[51] Since the registered broker-dealer would no longer have any responsibilities in this regard, it would have no reason to request the underlying information unless that request were made on behalf of the Commission, which would be entitled to receive it directly upon its own request under paragraph (a)(3)(i)(C).[52]

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[46] *See* proposed rule 15a-6(a)(3)(iii)(B). It is unclear why the foreign broker-dealer should be required to consent to service of process in a SRO proceeding since it would not be a member of any SRO and the rules of the SRO and its right to proceed against members in disciplinary matters is contractual. *See Brown v. Gilligan, Will & Co.*, 287 F. Supp. 766, 769 (S.D.N.Y. 1968).

[47] *See* proposed rule 15a-6(a)(3)(iii)(C).

[48] *See* proposed rule 15a-6(a)(3)(iii)(D).

[49] In fact, the consent on Form 8-M is broader than that required to be obtained by the U.S. registered broker-dealer under paragraph (a)(3)(iii)(B) in that it applies to civil actions or proceedings brought by anyone and before any tribunal – not just the SEC or an SRO.

[50] Alternatively, the foreign broker-dealer could be compelled to provide consents to service of process to an attorney or other agent in the U.S. that is not required to be a registered broker-dealer.

[51] *See* proposed rule 15(a)(6)(a)(3)(i)(B) and (C); and 15a-6(a)(3)(iii)(A)(i) and (ii); Proposing Release at 39194-95.

[52] Of course, without the requirements under paragraphs (a)(3)(iii)(B) and (C), the requirement under paragraph (a)(3)(iii)(D) would be unnecessary.

Finally, as noted above, the SEC already has established an effective model for obtaining assurance of the availability of books and records from non-resident U.S. registered broker-dealers by an undertaking pursuant to rule 17a-7(b) and consent to service of process on Form 8-M. To the best of our knowledge, there have been no reported cases of the Commission not being able to obtain the necessary information or jurisdiction using these mechanisms. Therefore, there is no reason to believe that they would not be just as effective for purposes of rule 15a-6.

We, therefore, suggest that the U.S. registered broker-dealer intermediation requirements of proposed rule 15a-6(a)(3)(iii) be eliminated for foreign broker-dealers conducting a foreign business and replaced with requirements by the foreign broker-dealer to provide the SEC with (1) a written undertaking to furnish to the Commission, on demand, any or all books and records made in connection with any transaction with a U.S. person pursuant to rule 15a-6(a)(3) and (2) consents by the foreign broker-dealer and each associated person authorizing the SEC (or an officer of the Commission) to accept service of process in any civil suit brought by the Commission.

C. The Foreign Business Test

The proposed amendments would enable a foreign broker-dealer to provide custody services to qualified investors under Exemption (A)(1) and to deal with U.S. fiduciaries of foreign resident clients under paragraph (a)(4)(vi) only to the extent that it conducts a foreign business,[53] in which at least 85 percent of the value of transactions with qualified investors and U.S fiduciaries of foreign resident clients, calculated on a rolling two-year basis, is conducted in "foreign securities."[54] A foreign security would include, among other things, any equity or debt security of a "foreign private issuer" as defined in rule 405 under the Securities Act.[55] The

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[53] *See* proposed rule 15a-6(b)(2)(ii).

[54] Proposed rule 15a-6(b)(5) would define "foreign security" to mean:

(i) An equity security (as defined in 17 CFR 230.405) of a foreign private issuer (as defined in 17 CFR 230.405);
(ii) A debt security (as defined in 17 CFR 230.902) of a foreign private issuer (as defined in 17 CFR 230.405);
(iii) A debt security (as defined in 17 CFR 230.902) issued by an issuer organized or incorporated in the United States in connection with a distribution conducted solely outside the United States pursuant to Regulation S (17 CFR 230.903);
(iv) A security that is a note, bond, debenture or evidence of indebtedness issued or guaranteed by a foreign government (as defined in 17 CFR 230.405) that is eligible to be registered with the Commission under Schedule B of the Securities Act of 1933; and
(v) A derivative instrument on a security described in paragraph (b)(5)(i), (b)(5)(ii), (b)(5)(iii), or (b)(5)(iv) of this section.

[55] Rule 405 defines the term "foreign private issuer" to mean:

any foreign issuer other than a foreign government except an issuer meeting the following conditions:

(1) More than 50 percent of the outstanding voting securities of such issuer are directly or indirectly owned or record by residents of the United States; and
(2) Any of the following:
(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

SEC's objective in limiting the services that could be provided by an unregistered foreign broker-dealer that does not conduct a business predominantly in foreign securities is "[to] provide U.S. investors increased access to foreign securities and markets without creating opportunities for regulatory arbitrage via-à-vis U.S. securities markets."[56] However, the reference to securities of foreign private issuers would pose a substantial burden on foreign broker-dealers in measuring compliance with the foreign business test, increasing substantially the cost of operating under the exemption. We believe that compliance with the rule could be made considerably easier by referring to more definitive criteria, such as the place of incorporation or the issuer's status as a reporting company in the United States, without compromising the Commission's objective of avoiding regulatory arbitrage by broker-dealers.

It would be very difficult to determine definitively a company's status as a foreign private issuer, and it would take a great deal of work to perform that function for numerous issuers whose securities were purchased or sold by U.S. investors over a two-year period. The foreign broker-dealer would have to perform extensive due diligence to learn the residence of the company's shareholder's, the citizenship and residence of its management, the location of its assets and the place in which its business is principally administered. This information may not be publicly available. While some foreign issuers may be reporting companies in the U.S. and elsewhere,[57] the information reported is often insufficient to determine the issuer's status as a foreign private issuer.[58] Admittedly, a foreign issuer that is not a U.S. reporting company is likely to be a foreign private issuer, but the foreign issuer's status as a non-U.S. reporting company is not dispositive in this regard.[59] Moreover, even the U.S. filings of companies on Forms F-1, F-3 and 20-F cannot be relied on to confirm the issuer's status as a foreign private issuer beyond the date of the filings. Even if the foreign broker-dealer were given comfort to rely on Securities Act and Exchange Act filings, it would mean reviewing the public records to

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(iii) The business of the issuer is administered principally in the United States.

"Foreign issuer" is defined under rule 405 to mean "any issuer which is a foreign government, a national of any foreign country or a corporation or other organization incorporated or organized under the laws of any foreign country."

[56] Proposing Release at 39190-91.

[57] A foreign company that raises capital or conducts various other kinds of transactions in the United States may be required to file a registration statement with the Commission. If the foreign issuer is a foreign private issuer it may make the required filing on Form F-1, F-3 or another form appropriate to the transaction, in which the issuer certifies that it meets the criteria for use of the form. Similarly, foreign private issuers required to file initial and annual reports pursuant to sections 12, 13, or 15(d) of the Exchange Act may make such filings on Form 20-F, in which it certifies that it meets the criteria to use that form.

[58] *See e.g.* Part I, Item 1 of Form 20-F, "Identity of Directors, Senior Management and Advisers," which requires that the issuer provide the names, business addresses and functions of the company's directors and senior management, but not the citizenship or residence of such persons; Part I, Item 7 of Form 20-F, "Major Shareholders and Related Party Transactions," which does not require disclosure of the residence of major shareholders (let alone the majority of shareholders); Part I, Item 4 of Form 20-F, "Information on the Company," which does not require disclosure of the location of the majority of the company's assets or even the identification of the place in which the business is principally administered apart from its headquarters.

[59] A foreign issuer may fail to meet the requirements of a foreign private issuer – because its shares are majority held by U.S. residents and the majority of its managers are U.S. persons or the majority of its assets are located in the U.S. or its business is administered from the U.S. – but not be required to file reports in the United States because it has not raised capital in the U.S and it has less than 500 equity shareholders or $1 million or less in total assets, such that it is not required to file reports under section 12(g) of the Exchange Act.

discern the status of hundreds or even thousands of issuers and conducting lengthy due diligence on non-U.S. reporting companies each year.

We understand that currently there is no available market data identifying foreign private issuers *per se.* Nor do we believe that any information service is likely to provide such data in the event that the proposed amendments are adopted given the varying nature of the definitional criteria and the lack of current public information available to make that assessment. This would mean that foreign broker-dealers could not automate the process for measuring compliance with the foreign business test. That would place a substantial burden on them to conduct the due diligence manually.[60] Some foreign broker-dealers may be unable or unwilling to absorb this expense, limiting U.S. investors' access to foreign market intermediaries, while others might be compelled to pass these costs on to U.S. investors.

For this reason we propose that the Commission choose more definitive criteria for evaluating a foreign security under the foreign business test. We suggest that it would be appropriate to refer to the equity or debt security of a "foreign issuer" as defined in rule 405 for purposes of the definition of foreign security in proposed rule 15a-6(b)(5)(i) and (ii), which would merely require confirmation of the issuer's status as a company organized or incorporated outside the United States. Alternatively, if the SEC would prefer to retain the foreign private issuer criteria in the definition, we suggest that the Commission consider framing the requirement in such a way that a third party service provider could safely determine the issuer's status in this regard: For example, an equity or debt security of a foreign issuer that is not a reporting company in the United States (other than a issuer that has filed its latest report as a foreign private issuer). This should allow foreign broker-dealers to obtain data needed to automate the process and greatly reduce the cost of compliance with the rule.

Neither of these alternatives is likely to compromise the SEC's objective of ensuring that broker-dealers conducting business with U.S. persons in U.S. securities do not locate (or relocate) themselves overseas to avoid U.S. regulation. Admittedly, some predominantly U.S. companies have organized or incorporated themselves overseas – primarily for tax considerations – and, therefore, their equity and debt securities would be considered foreign securities if the definition were based on foreign issuers instead of foreign private issuers.[61] However, the limited amount of business that might be conducted in these few issuers' securities is unlikely to affect any broker-dealer's decision to locate itself outside the Untied States in order to do that business on an unregistered basis. And nothing in the proposed rule would create any incentive for U.S. issuers to reorganize or reincorporate abroad – raising the prospect that U.S. broker-dealers might follow them offshore. Similarly, the number of foreign issuers that are not U.S. reporting companies but, nevertheless, do not meet the definition of foreign private issuer is

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[60] Some firms have already expressed concern for the amount of due diligence that would be involved in monitoring compliance with the foreign business test. *See, e.g.*, Letter of Howard Meyerson, General Counsel, Liquidnet Holdings Inc., dated August 13, 2008.

[61] *E.g.,* Accenture Ltd., Ingersoll-Rand Company Ltd., Tyco International Ltd.

likely to be quite small,[62] and should not be a factor in determining where the broker-dealer chooses to locate itself.[63]

Some commenters have suggested that the appropriate consideration in determining whether a foreign issuer's securities are foreign securities for purposes of this test should be the location of the primary market for the issuer's equity securities: The securities of issuers whose equity securities are traded primarily outside the U.S. would be considered foreign securities. We support this approach also, under standards that would make it clear whether the equity security's primary market is in the U.S. (or not) based on readily available information. We suggest that the SEC may wish to consider the standard adopted in the global research settlement in order to determine a non-U.S. company for which the U.S. is the principal equity trading market – *i.e.* the foreign issuer's securities would be considered foreign securities if more than 50 percent of the worldwide trading in the foreign issuer's common stock and equivalents takes place outside the United States, based on publicly reported share volume.[64]

D. Interpretive Relief on the Distribution of Research to Non-Qualified Investors

Finally, we recommend that the SEC confirm the continued application of the interpretative relief permitting foreign broker-dealers to distribute research to any U.S. person through a U.S. registered broker-dealer that accepts responsibility for the contents of the research and effects any resulting transactions.[65]

In the 1989 Adopting Release, the SEC stated that, although paragraph (a)(2) of rule 15a-6 permits a foreign broker-dealer to distribute research only to major U.S. institutional investors,

> the Commission would not require broker-dealer registration by a foreign broker-dealer whose research reports were distributed to U.S. persons by a registered broker-dealer, if that broker-dealer prominently stated on the research report that it had accepted responsibility for its content, if the research report prominently indicated that any U.S. persons receiving the

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[62] These mostly would consist of foreign issuers that – although they are majority owned by U.S. investors and have U.S. management, assets or administration – have total assets of not more than $1 million or less than 500 shareholders for each class of equity securities.

[63] Of course, a foreign-broker dealer could avoid the complexity of the foreign business test simply by choosing to operate under Exemption (A)(2), which does not require the firm to determine the extent of its business in foreign securities. However, those broker-dealers would not be able to handle customer funds and securities, which would significantly curtail their business. This would be the case even for those foreign firms that deal with customers on a delivery-versus-payment/receipt-versus-payment basis because they still would be required to "receive" and "deliver" customer funds and securities in connection with the clearance and settlement process.

[64] *See* section II, subparagraph 3 of the Undertakings in Addendum A to the Global Settlement with Ten Broker-Dealers, dated April 28, 2003.

[65] The Proposing Release states that "all prior no-action relief under rule 15a-6 would be superseded if the Commission were to adopt this proposed rule and interpretive guidance," and invites comment on whether there are "additional issues stemming from the 1989 Adopting Release or related staff guidance that are not addressed in the proposal and that should be addressed by this rule or interpretive guidance[.]" Proposing Release at 39201.

> research and wishing to effect any transactions in any security discussed in the report should do so with the registered broker-dealer, not the foreign broker-dealer, and if transactions with U.S. recipients of the report in any securities identified in the research actually were effected only with or through the registered broker-dealer, not the foreign broker-dealer.[66]

This position was subsequently re-affirmed by the SEC staff in a series of no-action letters.[67]

Continuation of the interpretive relief would be consistent with the SEC's stated policy of facilitating U.S. investors' access to foreign research while providing adequate regulatory protection with respect to the research and any resulting securities transactions.[68] Indeed, under the existing interpretive and no-action relief, U.S. investors are afforded substantially all of the protections of the U.S. securities laws. A U.S. registered broker-dealer is required to take responsibility for the contents of the research itself, which the Commission has said requires "tak[ing] reasonable steps to satisfy itself regarding the key statements in the research . . . and comparing it with other public information readily available regarding the issuer, to make certain that neither the facts nor the analysis appear inconsistent with outstanding information regarding the issuer."[69] Moreover, all resulting transactions would have to be performed by the registered broker-dealer, affording investors all of the protections of the Exchange Act and applicable SRO rules.

Accordingly, the existing interpretative position should be continued either by expressly including it within the terms of the proposed rule or by acknowledging its continued application in the release adopting the changes.

E. Interpretation of the Books and Records Maintenance Requirement under Exemption (A)(2)

There is some ambiguity about the scope of the recordkeeping requirement under Exemption (A)(2), the laws that would govern the creation and preservation of such records and the place in which they must be maintained, which the SEC may wish to address in any adopting release to the proposed amendments. Proposed rule 15a-6(a)(3)(iii)(A)(2)(i) provides that a U.S. registered broker-dealer shall be responsible for "[m]aintaining books and records, including copies of all confirmations issued by the [foreign broker-dealer] to the qualified investor, relating

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66 1989 Adopting Release at 30023 (footnotes omitted).

67 *See, e.g.*, Charterhouse Tilney, 1993 WL 277798 (publicly available July 15, 1993); Barclays PLC, 1991 WL 176731 (publicly available Feb. 14, 1991); Dean Witter Reynolds (Canada) Incorporated, 1990 WL 286238 (publicly available Mar. 1, 1990).

68 *See* Proposing Release at 39188 (citing 1989 Adopting Release at 30021). It also would be consistent with the Commission's policy of maintaining the basic parameters of paragraph (a)(2) of the current rule and expanding the class of investors to which it applies. *See id.*

69 1989 Adopting Release at 30023 n.116.

to any resulting transactions," but it does not expressly say whether any of those books and records could be maintained in accordance with foreign law or with the foreign broker-dealer.

We would expect that the Commission would take a functional approach to the application of the law governing the creation, maintenance and preservation of the books and records and where they may be maintained.[70] In this regard, those books and records ordinarily maintained by a U.S. registered broker-dealer in relation to its function as a clearing and carrying firm for qualified investors should be maintained in accordance with U.S. requirements. All other books and records with respect to functions performed exclusively by the foreign broker-dealer – including correspondence, order ticket preparation, trade execution and confirmations – could be created, maintained and preserved in accordance with the standards of the foreign broker-dealer's foreign regulator.[71] Similarly, it should be permissible to maintain books and records related to the foreign broker-dealer's services for qualified investors with the foreign broker-dealer outside the United States; although, admittedly, there is less support for this position under the provision as it is written.

CONCLUSION

Again, we thank you for the opportunity to express our views on this important subject. We hope that the SEC will find these comments useful. We would be pleased to discuss any of them with the Commission or its staff.

Respectfully,

Benjamin J. Catalano

Benjamin J. Catalano

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[70] *See* Proposing Release at 39193 ("Because the U.S. registered broker-dealer would carry the account of the qualified investor under Exemption (A)(*2*), we understand from discussions with industry representatives that it would be consistent with current business practices for the U.S. registered broker-dealer to maintain the books and records for transactions effected under this exemption.").

[71] We believe that this is in accordance with the Commission's intentions when it said that:

> Unlike under the current rule, under Exemption (A)(*2*), the intermediating U.S. registered broker-dealer would not be required to effect the transaction. Thus, with respect to transactions effected pursuant to 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, the rules thereunder and SRO rules applicable to a broker-dealer effecting a transaction in securities, unless it were otherwise involved in effecting the transaction. Proposing Release at 39193 (footnotes omitted).

Accordingly, books and records relating to functions performed by the U.S. registered broker-dealer would have to be made and preserved in accordance with rules 17a-3, 17a-4 and applicable SEC and SRO rules, while books and records not relating to functions performed by the U.S. registered broker-dealer could be maintained in accordance with other, non-U.S. standards. Otherwise, a foreign broker-dealer might be required to adhere to U.S. standards with respect to the creation and preservation of books and records made exclusively by it outside the U.S., such as trade memoranda, which must include specific information under rule 17a-3(a)(6) and (7) that may not be required under foreign law.

Paradigm Capital Inc.
95 Wellington Street West, Suite 2101
Toronto, Ontario M5J 2N7 Canada

Wellington West Capital Markets Inc.
145 King Street West, Suite 700
Toronto, Ontario M5H 1J8 Canada

cc: The Honorable Christopher Cox, Chairman
The Honorable Kathleen L. Casey, Commissioner
The Honorable Elisse B. Walter, Commissioner
The Honorable Luis A. Aguilar, Commissioner
The Honorable Troy A. Paredes, Commissioner
Mr. Erik R. Sirri, Director, Division of Trading and Markets