Foreign Broker-Dealers Providing Research Reports to and Initiating Follow-up Contact with Major U.S. Institutional Investors under Rule 15a-6(a)(2) and (3)

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A foreign broker-dealer that furnishes research reports to major U.S. institutional investors in reliance on the non-direct contact exemption in Rule 15a-6(a)(2) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), may initiate follow-up contacts with the recipients of that research in accordance with the direct contact exemption in Rule 15a-6(a)(3).[1]

I. Rule 15a-6

Rule 15a-6 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.[2] The rule provides exemptions from broker-dealer registration for, among other things, nondirect contacts by a foreign broker-dealer with major U.S. institutional investors[3] through the provision of research reports;[4] and direct contacts with U.S. institutional

1 The different requirements and additional limitations in the provision of research and limitations on follow-up contact with U.S. institutional investors who do not qualify as major U.S. institutional investors are discussed in the footnotes herein.

2 Section 15(a) of the Exchange Act requires a broker-dealer that uses the mails or any means of interstate commerce to effect transactions in or to induce or attempt to induce the purchase or sale of any security to register with the SEC. Broker-dealers located outside the United States that solicit transactions with persons in the United States are required to be registered, unless an exemption applies.

3 Rule 15a-6(b)(4) defines "major U.S. institutional investor" as a U.S. institutional investor with assets, or assets under management, in excess of $100 million (which may include the assets of any family of investment companies of which it is a part), or a registered investment adviser with assets under management in excess of $100 million. A "U.S. institutional investor" is a registered investment company, 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 staff of the U.S. Securities and Exchange Commission (the "SEC" or the "Commission") has expanded the definition of major U.S. institutional investor to include any entity that owns or controls (or, in the case of an investment adviser, has under management) assets in excess of $100 million ("$100 Million Entities"). See letter from Richard R. Lindsey, Director, Division of Market Regulation to Giovanni Prezioso, Cleary, Gottlieb, Steen & Hamilton (Apr. 9, 1997) (the "April 9, 1997 No-Action Letter").

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investors and major U.S. institutional investors through a U.S. registered broker-dealer intermediary, provided, in each case, that the other conditions of the rule are met. Although the rule, itself, has remained unchanged since its adoption in 1989, some of its provisions have been clarified (and, in effect, liberalized) through the issuance of no-action letters by the Commission staff.[5]

Rule 15a-6(a)(2)[6] permits a foreign broker-dealer to furnish research reports to major U.S. institutional investors, and effect transactions in the securities discussed in the reports with or for the major U.S. institutional investors, provided, among other things, that the foreign broker-dealer does not initiate contact with the institutions to follow up on the research reports, and does not otherwise induce or attempt to induce the purchase or sale of securities by the institutions.[7] If, however, the foreign broker-dealer has a relationship with a U.S. registered broker-dealer that fulfils the requirements of Rule 15a-6(a)(3), it must effect all transactions resulting from the provision of research through the registered broker-dealer pursuant to the provisions of Rule 15a-6(a)(3).

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,[8] the foreign broker-dealer

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4 The SEC takes the view that the provision of research to investors may constitute solicitation on the part of a broker-dealer. "Solicitation" is construed broadly by the Commission to include "any affirmative effort by a broker or dealer intended to induce transactional business for the broker-dealer or its affiliates." The Commission noted in the Adopting Release that "[b]roker-dealers often provide research to customers on a nonfee basis, with the expectation that the customer eventually will trade through the broker-dealer. They may provide research to acquaint potential customers with their existence, to maintain customer goodwill, or to inform customers of their knowledge of specific companies or markets, so that these customers will be encouraged to use their execution services for that company or those markets. In each instance, the basic purpose of providing the nonfee research is to generate transactional business for the broker-dealer. In the Commission's view, the deliberate transmission of information, opinions, or recommendations to investors in the United States, whether directed at individuals or groups, could result in the conclusion that the foreign broker-dealer has solicited those investors."

5 A party that is uncertain as to whether a proposed course of action would constitute a violation of the federal securities laws may seek a "no-action" letter from the Commission staff. The staff sometimes responds in the form of a no-action letter to requests for clarification of the legality of certain activities. If the staff grants a request for no action, the letter will conclude that the staff will not recommend that the Commission take enforcement action against the party based upon the facts and representations described in the party's original letter. No-action letters constitute *informal advice* on the part of the staff and do not legally bind the Commission.

In 2008, the SEC issued a rule proposal that would further liberalize the operation of Rule 15a-6 by, among other things, broadening the categories of U.S. investors with which a foreign broker-dealer may interact under the rule, effectively eliminating the chaperoning requirements, and substantially reducing the obligation of a registered broker-dealer to intermediate transactions (Release No. 34-58047). The rule proposal has not been adopted as yet. Please see our Broker-Dealer Regulatory Alert on the Proposed Amendments to Rule 15a-6.

6 Rule 15a-6(a)(2) permits a foreign broker-dealer to distribute research reports to major U.S. institutional investors directly or though a U.S. registered broker-dealer (affiliated or non-affiliated). The registered broker-dealer is not required to take responsibility for the content of research reports for which it acts as indirect distributor to major U.S. institutional investors under Rule 15a-6(a)(2). *See* the adopting release for Rule 15a-6 (Release No. 34-27017) (Jul. 11, 1989) (the "Adopting Release"). The foreign broker-dealer must comply, however, with the provisions of Regulation AC under the Exchange Act to the extent that it is associated with a U.S. registered broker-dealer and FINRA rules may apply to the extent that the research report is distributed through a FINRA member firm. If research is distributed to U.S. institutional investors who do not qualify as major U.S. institutional investors, a registered broker-dealer must accept responsibility for the research and the research reports must state this prominently; the research reports must indicate that any U.S. persons wishing to effect transactions in the securities described in the research do so through the registered broker-dealer; and all resulting transactions must, in fact, be effected by the registered broker-dealer.

7 In addition, the research reports must not recommend that the investor use the foreign broker-dealer to effect trades in any security, and the foreign broker-dealer must not provide the research pursuant to any express or implied understanding that the investor will direct commission income to the foreign broker-dealer (i.e., there cannot be any "soft dollar" arrangement between the investor and the foreign broker-dealer). According to the Commission, these limiting conditions are designed to permit the flow of research without allowing foreign broker-dealers to do more to solicit transactions with U.S investors. (Thus, if a foreign broker-dealer provided research pursuant to even an implied understanding that the investor would direct a given amount of commission income to the foreign broker-dealer, the foreign broker-dealer would be deemed to have induced purchases and sales of securities (irrespective of whether the trades received from the investor related to the particular research that had been provided) and the Rule 15a-6(a)(2) exemption would not apply.) *See e.g.*, the Adopting Release.

8 In addition, the foreign broker-dealer must agree to provide information, documents and testimony about the transactions to the SEC upon request, consent (along with its sales personnel) to service of process in the U.S., and provide to the registered broker-dealer

effects any resulting transactions through a U.S. registered broker-dealer in the manner prescribed by the rule.[9] As originally adopted, associated persons of the foreign broker-dealer who solicit U.S. investors ("Foreign Associated Persons") were required to conduct all securities activities from outside the United States, except that 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 an associated person of a registered broker-dealer that accepted responsibility for the Foreign Associated Person's communications with the U.S. institutional investor or major U.S institutional investor,[10] and an associated person of the registered broker-dealer participated in all other oral communications between the Foreign Associated Person and the U.S. institutional investor,[11] other than a major U.S. institutional investor. However, pursuant to the April 9, 1997 No-Action Letter, Foreign Associated Persons 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 Persons do not accept orders while in the United States to effect securities transactions.[12]

II. Contacts with Major U.S. Institutional Investors

The exemptions provided by paragraphs (a)(2) and (a)(3) of Rule 15a-6 are not mutually exclusive. Thus, foreign broker-dealers may rely on paragraph (a)(2) to send research to major U.S institutional investors, and engage in follow up contacts with those major U.S institutional investors pursuant to paragraph (a)(3). Although

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certain biographical and disciplinary information regarding its personnel so that the registered broker-dealer can determine whether to approve their participation in the Rule 15a-6 arrangement.

9 The registered broker-dealer is required to 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. The registered broker-dealer 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 record-keeping requirements; and maintaining, in an office of the registered broker-dealer located in the U.S., books and records relating to the transactions (including those required by Rules 17a-3 and 17a-4 under the Exchange Act), the foreign broker-dealer and the foreign broker-dealer's sales personnel. The registered broker-dealer must make the records available to the Commission upon request. The foreign broker-dealer may process records related to the transactions as long as the records comply with applicable requirements under U.S. law and the registered broker-dealer retains responsibility for and maintains the originals or copies of the records. The registered broker-dealer remains responsible for any aspects of the transaction it delegates to the foreign broker-dealer.

10 The chaperone must be familiar with any research reports discussed during these visits, must conduct a prior review of any written materials that are to be distributed and of any summaries or outlines of the Foreign Associated Person's oral presentation and must know whether the Foreign Associated Person's statements are consistent with the foreign broker-dealer's current recommendations. The Adopting Release states that the responsibility imposed on the registered broker-dealer and its employees for these visits is the same as if the registered broker-dealer were acting directly on its own behalf.

11 In accordance with the April 9, 1997 No-Action Letter, a Foreign Associated Person may engage in oral communications with a U.S. institutional investor that does not qualify as a major U.S. institutional investor *without* the participation of an associated person of the registered broker-dealer if such communication takes place outside NYSE trading hours and no orders to effect transactions other than those involving foreign securities are accepted. (The term "foreign security" comprises (i) a security issued by an issuer not organized or incorporated under the laws of the United States, when the transaction in such security is not effected on a U.S. exchange (including a depositary receipt issued by a U.S. bank but only if it is initially offered and sold outside the United States in accordance with Regulation S under the Securities Act), (ii) a debt security (including a convertible debt security) issued by an issuer organized or incorporated in the United States in connection with a distribution conducted outside the United States, or (iii) any over-the-counter derivative instrument on an instrument described in (i) or (ii) above; *provided*, *however*, that debt securities of an issuer organized or incorporated under the laws of the United States do not constitute "foreign securities" if they are offered and sold as part of a "global offering" involving both a distribution of the securities in the United States under a Securities Act registration statement and a contemporaneous distribution outside the United States.)

12 Such unchaperoned communications are permitted in part due to the existence of other provisions of the rule that require review of the background of Foreign Associated Persons who contact U.S. investors. In addition, the SEC takes the view that oversight of the conduct of foreign sales personnel may be of less significance where they are soliciting only U.S. investors with high levels of assets, on the assumption that the institutions or their investment advisers have the skills and experience to assess independently the integrity and competence of the foreign broker-dealers and its personnel.

paragraph (a)(2), by its terms, contemplates that a foreign broker-dealer operating thereunder may have established simultaneously a relationship with a registered broker-dealer for the purpose of operating under paragraph (a)(3), the Adopting Release did not explicitly address the intersection between the two paragraphs. In a footnote to the Rule 15a-6(a)(2) prohibition on initiating follow-up contact with major U.S. institutional investor recipients of research reports, the Commission did note, however, that "[i]f a foreign broker-dealer wished to initiate direct contact with U.S. persons, it could do so using the direct contact exemption in paragraph (a)(3) of the Rule, and the conditions imposed by that exemption, including the participation of a registered broker-dealer intermediary, would address the investor protection concerns raised by those contacts."[13]

III. Requirements Applying to Foreign Associated Persons of a Foreign Broker-Dealer Engaging in Follow-up Contacts with U.S. Investors

In order for Foreign Associated Persons of a foreign broker-dealer to engage in sales activities with U.S. investors pursuant to Rule 15a-6(a)(3), certain conditions must be met by the foreign broker-dealer, the Foreign Associated Persons and the U.S. registered broker-dealer intermediary. Each Foreign Associated Person must provide to the U.S. registered broker-dealer written consent to service of process for any civil action brought by, or proceeding before, the Commission or a self-regulatory organization. The consent must provide that process may be served on the Foreign Associated Person by service on the U.S. registered broker-dealer.[14]

In addition, the U.S. registered broker-dealer must conduct due diligence on the background and disciplinary history of the Foreign Associated Persons, and, in particular, must determine that they are not subject to a statutory disqualification or certain substantially equivalent foreign disciplinary actions.[15] In this regard, it must procure, with respect to each Foreign Associated Person, information specified in Rule 17a-3(a)(12) under the

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[13] Adopting Release, text at footnote 110. Following the promulgation of Rule 15a-6, several foreign broker-dealers sought assurance from the Commission staff through no-action requests that they could distribute research reports in accordance with the rule without such activity triggering a requirement to register under the Investment Advisers Act of 1940 (the "Advisers Act"). (The SEC takes the position that the exclusion from the definition of "investment adviser" in Section 202(a)(11)(C) of the Advisers Act applies only to broker-dealers that are *registered* under the Exchange Act. Accordingly, a foreign broker-dealer that is not registered under the Exchange Act and that provides research to U.S. persons would fall within the definition of investment adviser and generally would be required to register under the Advisers Act, absent such relief.) In accordance with Rule 15a-6(a)(2), these foreign firms would furnish research reports and effect transactions in the securities discussed in such reports with or for major U.S. institutional investors. The firms all asserted that they would not initiate follow-up contact with any of the major U.S. institutional investors to whom the research reports were furnished *other than in accordance with the direct contact exception contained in paragraph (a)(3) of Rule 15a-6.* In accordance with that exception, the firms, through direct contacts with major U.S. institutional investors, would induce or attempt to induce the purchase and sale of securities by such investors. While this might be done primarily through the distribution of their research reports by U.S. registered broker-dealer affiliates, *nothing would preclude [the firms] from having other contacts with such investors in accordance with the requirements of paragraph (a)(3).* Any transactions with the firms resulting from the distribution of the research reports to, or other direct contacts with, major U.S. institutional investors would be effected through the U.S. registered broker-dealer affiliates pursuant to the provisions of Rule 15a-6(a)(3). In granting the no-action relief, the Commission staff acknowledged that the firms would operate as research distributors under Rule 15a-6(a)(2) *and* would initiate follow-up contacts with the major U.S. institutional investor recipients of the research in accordance with Rule 15a-6(a)(3). *See, Dean Witter Reynolds Inc.* (*Canada*) (Mar. 1, 1990); *Barclays PLC* (Feb. 14, 1991); Charterhouse Tilney (Jul. 15, 1993). The issue was clarified more definitively in the April 9, 1997 No-Action Letter, a no-action request by nine major U.S. registered broker-dealers, who sought, among other things, an expansion of the definition of major U.S. institutional investor and a liberalization of the chaperoning requirements of Rule 15a-6(a)(3). In a footnote in its response granting the relief, the Commission staff expressly confirmed, at the request of the broker-dealer petitioners, that "the limitations set forth in paragraph (a)(2)(ii) of Rule 15a-6 would not prohibit a foreign broker-dealer from initiating follow-up contacts with major U.S. institutional investors … to which it has furnished research reports, if such follow-up contacts occur in the context of a relationship between a foreign broker-dealer and a U.S. intermediary broker-dealer under the Rule." *See* the April 9, 1997 No-Action Letter, text at footnote 6. While no-action letters generally may be relied upon only by the addressees, the Commission staff stated that the assurances in the letter would apply to both the broker-dealer petitioners and to similarly situated broker-dealers.

[14] Rule 15a-6(a)(3)(D).

[15] Rule 15a-6(a)(3)(B).

Exchange Act.[16] The written consents and information described above must be maintained by the U.S. registered broker-dealer as part of its books and records and made available to the Commission upon request.

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Please contact us if you would like to discuss the issues raised herein in more detail.

[16] Rule 15a-6(a)(3)(C). This information includes the Foreign Associated Person's name; address; social security number or foreign equivalent; the starting date of employment or other association with the foreign broker-dealer; date of birth; a complete, consecutive statement of all the Foreign Associated Person's business connections for at least the preceding ten years, including whether the employment was part-time or full-time; a record of any denial of membership or registration, and of any disciplinary action taken, or sanction imposed, upon the Foreign Associated Person by any agency, or by any securities exchange or securities association, including any finding that the Foreign Associated Person was a cause of any disciplinary action or had violated any law; a record of any denial, suspension, expulsion or revocation of membership or registration of any foreign broker-dealer with which the Foreign Associated Person was associated in any capacity when such action was taken; a record of any permanent or temporary injunction entered against the Foreign Associated Person or any foreign broker-dealer with which the Foreign Associated Person was associated in any capacity at the time such injunction was entered; a record of any arrest or indictment for any felony or foreign equivalent, or any misdemeanor or foreign equivalent pertaining to securities, commodities, banking, insurance or real estate (including, but not limited to, acting or being associated with a foreign broker-dealer), fraud, false statements or omissions, wrongful taking of property or bribery, forgery, counterfeiting or extortion, and the disposition of the foregoing; and a record of any other name or names by which the Foreign Associated Person has been known or which the Foreign Associated Person has used.