Summary of the Proposed Amendments to Rule 15a-6 under the Exchange Act

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The Securities and Exchange Commission ("SEC" or the "Commission") has 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 Commission for foreign broker-dealers that conduct limited activities in the United States.[1] 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 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 range 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.

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 securities discussed in the

[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.

[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 Web site 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:
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> (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

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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 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.

The unsolicited transaction exemption in paragraph (a)(1) is of scant utility to U.S. investors looking to trade abroad 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.

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 constrained similarly 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 prevented U.S. investors' access

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(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).

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.

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 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

[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 the meaning of the Employee Retirement Income Security Act of 1974, other than an 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;
(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.

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-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]

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[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).

[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

We agree with the Commission's objectives in advancing the proposed amendments. 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.

Please refer to our comment letter on the proposed amendments, which contains a more in-depth discussion of the proposal and our suggested changes to address these concerns.

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

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).