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SEC Releases Responses to Frequently Asked Questions Regarding Rule 15a-6 and Foreign Broker-Dealers

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On March 21, 2013, the staff of the Division of Trading and Markets (the "Staff") of the US Securities and Exchange Commission (the "SEC") released responses reflecting the Staff's views on frequently asked questions (the "FAQs") relating to Rule 15a-6 ("Rule 15a-6" or the "Rule") under the US Securities Exchange Act of 1934, as amended (the "Exchange Act"). The FAQs affirm, among other things, the SEC's broad interpretation of Rule 15a-6 confirming the applicability of both the "Seven Firms" and "Nine Firms" to foreign broker-dealers, including those that use unaffiliated US-registered broker-dealers to intermediate transactions in accordance with Rule 15a-6(a)(3). This memorandum provides a brief background of Rule 15a-6 and highlights the important points included in the FAQs.

Introduction

Broker-dealers[1] located outside the United States that conduct securities transactions with persons in the United States (including solicitation of those transactions) are required to register with the SEC, unless an exemption from registration is available. Rule 15a-6 under the Exchange Act, which the SEC adopted in 1989, currently provides a conditional exemption from broker-dealer registration for a non-US broker-dealer

[1] The term "broker" is generally defined at Section 3(a)(4) of the Exchange Act as a person engaged in the business of effecting transactions in securities for the account of others. The term "dealer" is defined at Section 3(a)(5) of the Exchange Act as a person engaged in the business of effecting transactions in securities for his or her own account.

falling under the definition of "foreign broker or dealer"[2] that engages in certain activities involving certain US investors. Since the adoption of Rule 15a-6, the Staff has expanded its scope through "no action" and other interpretive guidance.[3] In 2008, the SEC proposed changes to update and expand the scope of the rule, but that proposal has yet to be adopted.

Background – Summary of Rule 15a-6

In order to facilitate access to non-US markets by US investors, and to provide guidance to "foreign broker-dealers", as defined, seeking to solicit brokerage business from persons in the United States, the SEC adopted Rule 15a-6 in 1989 and issued subsequent guidance that expanded the ability of unregistered non-US broker-dealers to conduct securities transactions with US customers.

Rule 15a-6 provides conditional exemptions from registration under the Exchange Act that permit non-US broker-dealers to engage in certain activities in the United States, and/or with US persons without having to register with the SEC. The activities that non-US broker-dealers may engage in under this regulatory framework include:

- Effecting unsolicited transactions.
- Provision of research reports to certain US institutional investors without "follow-up" solicitation of transactions.
- Effecting solicited transactions (including the distribution of research) with US institutional investors with the assistance of a US-registered broker-dealer intermediary. The role of the US-registered broker-dealer varies based on certain criteria, the most important of which is whether the client is a "major US institutional investor" (generally, a person that owns or invests $100 million or more) or a "US institutional investor" (generally, an enumerated institutional investor owning or investing less than $100 million); and
- Effecting transactions on any terms with certain specified counterparties, notably any US-registered broker-dealer, or any bank acting in accordance with an exemption from the broker-dealer registration requirements.

The scope of Rule 15a-6 has been expanded over the years through a series of related no-action letters, specifically the so-called "Seven Firms Letter" and the "Nine Firms Letter". The Seven Firms Letter, issued January 30, 1996, granted relief to foreign broker-dealers that effect transactions in non-US securities with US resident fiduciaries, such as

[2] Rule 15a-6(b)(3) defines a "foreign broker or dealer" as any non-US resident person (including any US person engaged in business as a broker or dealer entirely outside the United States, except as otherwise permitted by this rule) that is not an office or branch of, or a natural person associated with, a registered broker or dealer, whose securities activities, if conducted in the United States, would be described by the definition of "broker" or "dealer" in Section 3(a)(4) or 3(a)(5) of the Exchange Act. Throughout this note, the terms "foreign broker-dealer" and "non-U.S. broker-dealer" are used to reference this defined term in Rule 15a-6.

[3] For example, see the SEC "no action" Letter re: Securities Activities of US-Affiliated Foreign Dealers (January 30, 1996) (the "Seven Firms Letter"), Letter re: Securities Activities of US-Affiliated Foreign Dealers (April 9, 1997) (the "Nine Firms Letter"), and Letter from the SEC to Shearman & Sterling LLP (November 28, 2007) (the "LiquidityHub Letter" or the "Shearman & Sterling Letter"). For more information regarding Rule 15a-6 and the associated interpretive guidance, please *see* Charles S. Gittleman, "SEC Loosens Regulation of Foreign Broker-Dealers" *International Financial Law Review*, October 1997.

investment advisers, on behalf of non-US clients.[4] It acknowledged that offshore clients would not reasonably expect the US broker-dealer requirements to apply to their transactions in non-US securities merely because their accounts were managed by US resident fiduciaries. As a result, foreign broker-dealers are allowed to effect transactions in non-US securities with US resident fiduciaries for offshore clients without either registering as a broker-dealer in the United States or effecting the transactions through a US-registered broker-dealer in accordance with the Rule.[5]

The Nine Firms Letter, issued April 9, 1997, greatly expanded the breadth of business that can be transacted between US institutional investors and major US institutional investors, and foreign broker-dealers without the requirement of a "chaperone". It established an expanded interpretation of the definition of "major US institutional investor" to include any entity that owns or controls (or, in the case of an investment adviser, has under management) in excess of $100 million in financial assets.[6] It also significantly relaxes the intermediation requirements, specifically permitting foreign broker-dealers to clear and settle transactions through the direct transfer of funds between the US investor and the foreign broker-dealer.

Summary of 2013 Frequently Asked Questions

Effecting Transactions with of a Non-US Person Temporarily Present in the United States

Under Rule 15a-6(a)(4)(iii) a foreign broker-dealer may solicit transactions from non-US persons who are temporarily present in the United States and with whom the foreign broker-dealer had a pre-existing relationship. The question posed to Staff was whether a person who is in the US for a finite period of time (for example, for employment or education purposes) and who affirmatively acknowledges a pre-existing relationship with a foreign broker-dealer may be considered "temporarily present" for the purposes of the rule. While acknowledging that such determinations are fact-specific, it is the Staff's view that a foreign broker-dealer may effect a transaction, pursuant to the exemption provided by Rule 15a-6(a)(4)(iii), with such a person so long as that person (i) is not a US citizen and (ii) is not a lawful permanent resident of the US (i.e. a "Green Card holder").[7]

The LiquidityHub Letter, issued November 28, 2007, confirmed the permissibility of a non-US broker-dealer's reliance on multiple US-registered broker-dealers, including unaffiliated US broker-dealers, in connection with the intermediation requirements found at Rule 15a-6(a)(3). That letter also described one method by which a non-US broker-dealer operating principally as an electronic system can rely on Rule 15a-6.

In 2008, the SEC proposed major amendments that would have liberalized the Rule.[8] These amendments have yet to be adopted by the SEC.

[4] The Seven Firms Letter.

[5] The Seven Firms Letter contains relief analogous to that provided under Regulation S for offerings made to non-US persons whose accounts are held by a US fiduciary.

[6] The Nine Firms Letter.

[7] The use of the term "permanent resident" is important inasmuch as this recognizes the reliance on Rule 15a-6(a)(4)(iii) by holders of a nonimmigrant visa (such as holders of a H1-B Visa) who are seeking to maintain financial services relationships with non-US broker-dealers.

[8] For a description of these proposed amendments, please refer to our previous client publication, which is available at http://www.shearman.com/am_070908/.

Employee Benefit Plans

As a general matter, almost any contact initiated by a foreign broker-dealer with a prospective US investor is considered solicitation of a securities transaction by the SEC.[9] This has proved troublesome in situations involving employee stock option plans ("ESOP") or other employee benefit plans administered by non-US broker-dealers on behalf of non-US issuers with US-based employees. In practice, the administration of employee benefit plans by non-US broker-dealers involves regular contact and communication that has traditionally been difficult to read in a manner consistent with Rule 15a-6 and associated interpretive guidance, notwithstanding that the contact and communication is limited in nature.

Staff has addressed this issue in the FAQs, taking the view that a foreign broker-dealer in such a situation would not be considered to have solicited a US employee (or US subsidiary) in connection with the administration of an employee benefit plan, provided that the following criteria are met:

- the foreign broker-dealer deals exclusively with management and employee representatives from the foreign issuer;
- that such management and employee representative personnel are not located within the US; and
- that the foreign broker-dealer's activities with respect to US persons are limited to (a) facilitating the transfer of the foreign issuer's securities to the US-based employee, (b) sending required plan documents, account statements, confirmations, privacy notices, prospectuses, proxy statements or other legally required documents to the employee, and (c) selling, transferring, or otherwise disposing of the foreign issuer's securities. In each case, the activity described in (a) through (c) above must relate to foreign securities acquired by the applicable employee in connection with the applicable employee benefit plan.

In such circumstances, the Staff would consider that solicitation by the foreign broker-dealer would be directed to the foreign issuer, rather than to employees who are present in the US

Unsolicited Transactions by a Foreign Broker-Dealer

Where a foreign broker-dealer effects an unsolicited transaction on behalf of a US investor in reliance on Rule 15a-6(a)(1), it is the Staff's view that such foreign broker-dealer may provide the US investor with a confirmation of the transaction, periodic account statements, and other documents related to the transaction that are required under foreign law. Consistent with Staff's broad view of what constitutes solicitation, the foreign broker-dealer may not, however, provide any document that includes advertising or other material intended to induce further business. In response to another FAQ, the Staff further noted that reliance on Rule 15a-6(a)(1) would not necessarily preclude a foreign broker-dealer from effecting additional unsolicited transactions on behalf of the same US investor, so long as such transactions were in fact unsolicited.

[9] The term "solicitation" is interpreted broadly by the SEC to include "any affirmative effort by a broker-dealer intended to induce transactional business for the broker-dealer or its affiliates." Solicitation includes both efforts to develop an ongoing securities business relationship and efforts by a broker-dealer to induce a single transaction. Conduct by a person deemed to be solicitation include (a) telephone calls from a broker-dealer to a customer encouraging the use of the broker-dealer to effect transactions, (b) advertising one's function as a broker, and (c) recommending the purchase or sale of particular securities with the anticipation that the customer will execute the recommended trade through the broker-dealer.

Intermediation and Transactions

As previously discussed, Rule 15a-6 permits a foreign broker-dealer to contact major US institutional investors without the participation of an associated person of a registered broker-dealer in any such contacts.[10] In each case, any resulting transactions must be effected through an intermediary US-registered broker-dealer. The registered broker-dealer is required to handle most aspects of such transactions among the exceptions being the negotiation of their terms and the execution of the transactions in the relevant foreign markets.[11] Rule 15a-6(a)(3)(iii) sets forth the specific items for which the US-registered broker-dealer through which the transaction is effected is responsible, including items that the foreign broker-dealer must provide to the US-registered bro ker-dealer.[12] One such requirement is for the intermediating broker-dealer to issue all required confirmations and statements related to the transaction.

Among the questions posed in the FAQs is whether a foreign broker-dealer may send confirmations and account statements directly to US counterparties if required under foreign law. In response, the Staff provided its view that a foreign broker-dealer may send such statements directly to US counterparties if required by foreign law or internal policies and procedures. However, this does not relieve the intermediating broker-dealer of its obligation to ensure that confirmations and account statements are sent to the investor in a manner compliant with all applicable US requirements, including Rule 10b-10 under the Exchange Act and applicable FINRA rules. In addition, the Staff noted that the intermediating broker-dealer must comply with Exchange Act Rules 17a-3[13] and 17a-4,[14] and is responsible for the accuracy of its books and records.

Distribution of Research to Major US Institutional Investors

Rule 15a-6 provides an exemption permitting any foreign broker-dealer to provide research to a "major US institutional investor". Specifically, the Rule permits any foreign broker-dealer, without registration, to provide research reports to major US institutional investors[15] without the intermediation of any person, provided that:

- the report does not recommend the use of the foreign broker-dealer to effect trades,

[10] *See* Rule 15a-6(a)(3)(iii)(B); *see* also "Registration Requirements for Foreign Broker-Dealers", July 11, 1989, Release No. 34-27017 (adopting Rule 15a-6).

[11] The Nine Firms Letter also notes that a non-US broker-dealer may, in settlement of such transactions, transfer funds and securities directly to the US institutional investor, or, more commonly, the custodian or prime broker of the US institutional investor.

[12] *See* Rule 15a-6(a)(3)(iii)(A)(1)-(6) and 15a-6(a)(3)(B) through (E).

[13] Rule 17a-3 requires detailed records be kept recording securities transactions, including an itemized daily record of all transactions and records of securities accounts and copies of confirmations of all purchases and sales of securities. Rule 17a-3 (through Rule 15a-6) also requires the chaperoning broker-dealer to maintain detailed information regarding the associated persons of the foreign broker-dealer who are soliciting transactions with major US institutional investors.

[14] Rule 17a-4 sets forth the period for which these records are required to be preserved by the chaperoning registered broker-dealer. The chaperoning US broker-dealer must maintain a written record of the above information and consents for service of process from the associated persons of the foreign broker-dealer in its office and make those records available to the SEC upon request.

[15] The term "major US institutional investor" is defined and interpreted by the SEC to include any entity, including any US investment advisor whether or not registered under US law, which owns or controls in excess of $100 million in aggregate financial assets.

- the foreign broker-dealer does not initiate contact with such major US institutional investors to follow up on the research reports (e.g., by a follow-up telephone call), and does not otherwise induce or attempt to induce the purchase or sale of any security by such major US institutional investor,
- the research is not provided under any express or implied soft dollar arrangement, and
- if the foreign broker-dealer has a relationship[16] with a registered broker-dealer as described in Rule 15a-6(a)(3), any transactions resulting from the provision of the research are effected through that registered broker-dealer in accordance with the procedures described in the Rule.[17]

In the FAQs, the Staff affirms that Rule 15a-6(a)(2) permits a foreign broker-dealer to furnish research reports to major US institutional investors without any intermediation or other involvement of a registered broker-dealer.

The Seven Firms Letter and Nine Firms Letter Apply to All Foreign Broker-Dealers

As previously discussed, the Seven Firms Letter and Nine Firms letter greatly expanded the scope of Rule 15a-6. It has been widely believed that both letters represented broader statements of policy by the SEC regarding the interpretation of the Rule and their applicability to foreign broker-dealers; however, cautionary language included by the SEC left the door open for an alternative interpretation. The Staff has now confirmed that both the Nine Firms Letter and Seven Firms Letter apply generally to all foreign broker-dealers, not just those affiliated with registered broker-dealers. This view was also confirmed by Staff in 2007 in the Shearman & Sterling Letter, which permitted the reliance on Rule 15a-6 by a non-US broker-dealer in a circumstance in which Rule 15a-6 intermediation was contemplated to be conducted by nonaffiliated US-registered broker-dealers. Further, the Staff has affirmed that the expanded view of the term "major US institutional investor", as described in the Nine Firms Letter, applies to all provisions of Rule 15a-6.

Net Capital Rule

In the FAQs, the Staff addressed several questions pertaining to the minimum net capital and other regulatory capital requirements for US-registered broker-dealers acting as intermediaries to foreign broker-dealers:

- A registered broker-dealer that enters into a "chaperoning" agreement with a foreign broker-dealer under Rule 15a-6(a)(3) is subject to a minimum net capital requirement of at least $250,000. However, a chaperoning broker-dealer that has entered into a fully-disclosed carrying agreement with another registered broker-dealer that has agreed to comply with the SEC's broker-dealer financial responsibility rules with respect to the chaperoning agreement, would be subject to a minimum net capital requirement of $5,000 (or such other greater amount as would be required under Rule 15c3-1 based on the broker-dealer's activities).

[16] The relationship described by Rule 15a-6(a)(3) requires a relationship between the foreign broker-dealer and a US-registered broker-dealer to, among other things, (a) effect transactions conducted under Rule 15a-6 (other than negotiating their terms), (b) issue all required confirmations and statements to the US investor, (c) maintain required books and records relating to the transactions, and (d) obtain from the foreign broker or dealer, with respect to each foreign associated person, certain personal and professional information, including a consent to service of process.

[17] A foreign broker-dealer that does not have such a relationship with a registered broker-dealer may also, without the intermediation of a US-registered broker-dealer, effect transactions in the securities discussed in the research report with the major US institutional investor if the other requirements mentioned above are met.

- An introducing broker-dealer cannot rely on Rule 15c3-3(k)(2)(i) exception and maintain net capital of $100,000 while acting as a "chaperone" for a foreign broker-dealer under Rule 15a-6(a)(3) and relying on the Nine Firms Letter. As mentioned above, the minimum net capital requirement of at least $250,000 is required unless the introducing broker-dealer has entered into a fully disclosed carrying agreement with another registered broker-dealer. Consequently, a broker-dealer acting as a chaperone under Rule 15a-6(a)(3) for "DVP/RVP" transactions with institutional investors must maintain a minimum net capital of at least $250,000.
- If a foreign broker-dealer's business under Rule 15a-6 is limited to giving advice to a US institutional investor or major US institutional investor contemplating an acquisition of a company, then by virtue of that activity the "chaperoning" broker-dealer's minimum net capital requirement is $5,000.
- A registered broker-dealer acting as a "chaperone" in connection with securities transactions with a US institutional investor or major US institutional investor is required also to take a capital charge for failed transactions, even if the foreign broker-dealer is required to record a charge in respect of such failed transaction in accordance with the law or regulation of another jurisdiction.

Conclusion

Notwithstanding the helpful guidance provided in the FAQs, compliance with Rule 15a-6 remains complex, particularly in light of the many different businesses conducted around the world by entities that qualify as "foreign broker-dealers" under the Rule. Accordingly, foreign broker-dealers seeking to avail themselves of the benefits of Rule 15a-6 should continue to pay close attention to both the substantive and mechanical aspects of the Rule.

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