News Bulletin

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Chipping Away at Barriers to Global Financial Services: SEC Staff Addresses Issues for Foreign Broker-Dealers under Rule 15a-6

Noting the increasingly global nature of financial markets, the U.S. Securities and Exchange Commission ("SEC") adopted Rule 15a-6 nearly twenty four years ago to facilitate limited access by foreign broker-dealers to customers in the United States. During the years since the rule's adoption, globalization of world financial markets has accelerated, but the SEC has only gradually relaxed the restrictions set forth in Rule 15a-6. The staff of the SEC's Division of Trading and Markets (the "Staff") continued this process of incremental change through a series of frequently asked questions ("FAQs") issued on March 21, 2013.[1]

Background

Under Section 15 of the Securities Exchange Act of 1934 (the "Exchange Act"), any person engaged in the business of effecting securities transactions is required to register with the SEC as a broker-dealer. This requirement applies to foreign broker-dealers conducting business with U.S. customers, even if all of the transactions are in foreign securities and are effected outside the United States. In 1989, the SEC adopted Rule 15a-6 in order to provide foreign broker-dealers with limited access to U.S. customers without having to register with the SEC. That rule, as interpreted by no-action letters issued in 1996[2] and 1997[3], permits foreign broker-dealers to:

- Effect transactions for U.S. persons who contact them on an unsolicited basis;
- Provide research reports to Major Institutional Investors (investors with at least $100 million of investments);
- Solicit business with Major Institutional Investors and Institutional Investors (registered investment companies, banks, insurance companies, etc.) subject to a variety of procedural requirements requiring the involvement of a U.S. broker-dealer (the "Chaperoning Broker"); and
- Conduct business without limitation with certain categories of persons such as foreign nationals temporarily present in the United States.

In the recently issued FAQs, the Staff clarified important matters relating to dealings with unsolicited customers, persons temporarily in the United States and global ESOPs, confirmed widely accepted interpretations of the no-action letters issued in 1996 and 1997 and reiterated the importance of Chaperoning Brokers discharging their obligations under Rule 15a-6.

[1] http://www.sec.gov/divisions/marketreg/faq-15a-6-foreign-bd.htm.
[2] The "Seven Firms Letter" issued on January 30, 1996.
[3] The "Nine Firms Letter" issued on April 9, 1997.

Conducting Business with Expatriates

Rule 15a-6 permits foreign broker-dealers to conduct business with persons who are "temporarily present" in the United States, provided that the broker-dealer had a pre-existing relationship with the customer. In the release adopting Rule 15a-6, [4] the SEC declined to define what would constitute "temporary" presence and referred to existing legal standards on "residency", citing to Internal Revenue Code provisions.[5] The SEC also gave the example of a Canadian broker-dealer conducting business with a Canadian who was vacationing in Florida.

This construct created potential problems for foreign broker-dealers seeking to continue their dealings with customers who were assigned to long term positions in the United States. An expatriate executive sent to work at his company's U.S. subsidiary for a four year term would by many measures be deemed to "reside" in the United States during his tenure.

In the FAQs, the Staff stated that foreign persons would be deemed temporarily in the United States provided that they were not U.S. citizens or permanent residents ("green card holders"). This constitutes an important clarification by the Staff which should enable foreign broker-dealers to continue their dealings with customers who re-locate to the United States for an extended period, either as expatriate workers or students.

Conducting Unsolicited Business with U.S. Residents

Rule 15a-6 permits foreign broker-dealers to effect transactions for U.S. persons if neither the transaction nor the customer relationship were solicited by the foreign broker-dealer. However, the SEC has always interpreted "solicitation" quite broadly to include any efforts to induce transactions or the establishment of a brokerage account.

In the FAQs, the Staff stated that a foreign broker-dealer conducting business on an unsolicited basis with a U.S. customer could send that customer confirmations, account statements and required legal documents, and such communications would not be deemed "solicitation" by the foreign broker-dealer. However, the Staff warned that advertising materials would constitute solicitation. Consequently, foreign broker-dealers will be free to mail confirmations and account statements to their unsolicited U.S. customers, but should be careful not to include any advertising inserts.

The FAQs also note that it would be possible for a foreign broker-dealer to have more than one unsolicited transaction with the same U.S. customer. In this regard, the Staff stated that such questions would have to be resolved on a case by case basis, with a particular focus on the facts pertaining to the nature of communications between the broker-dealer and the customer. While this seems reasonable enough, the Staff also expressed some skepticism about whether a foreign broker-dealer could conduct a significant number of transactions with a U.S. customer without crossing the line into a solicited relationship. Such skepticism is inconsistent with the Staff's fundamental point that these relationships must be analyzed on a case by case basis. There is no reason why Rule 15a-6 should not apply to a U.S. customer who approaches a foreign broker-dealer on an unsolicited basis and, satisfied with the services performed, sends additional unsolicited orders to such broker.

Conducting Business with Global ESOPs

The FAQs clarify the ability of a foreign broker-dealer to conduct business with a global ESOP established by a foreign issuer that covers U.S. employees of the issuer. The Staff provides a number of important guidelines for such situations. In administering the plan, the foreign broker-dealer should work exclusively with representatives of the foreign issuer who are located outside the United States. Its activities with respect to U.S. persons covered

[4] Release No. 34-27017, available at 54 FR 30013.
[5] The Internal Revenue Code provisions deal with a taxpayer's residency based on the number of days during the year that the taxpayer is physically present in a particular country.

by the ESOP should be limited to sending plan documents, facilitating securities transfers and selling the foreign issuer's securities.

The foreign broker-dealer may actively solicit the ESOP business from the foreign issuer and such activities will not be deemed solicitation of U.S. persons even though the ESOP covers U.S. employees. However, such solicitation efforts must be conducted entirely outside the United States and must not be directed at any persons located in the United States.

Confirmation of the Applicability of the 1996 and 1997 No-Action Letters

As noted above, the Staff issued important no-action letters in 1996 and 1997, expanding and/or clarifying the scope of Rule 15a-6. The no-action letters were issued at the request of several major U.S. investment banking firms and covered certain activities by their foreign affiliates. Since their issuance, practitioners have generally viewed the no-action letters as being applicable to all foreign broker-dealers.

In the FAQs, the Staff confirms that both no-action letters apply to all foreign broker-dealers, including those that have no affiliation with any U.S. broker-dealers.

The Role of Chaperoning Brokers

Under Rule 15a-6(a)(iii), Chaperoning Brokers play an essential role when foreign broker-dealers solicit business with U.S. Institutional Investors and Major Institutional Investors. The FAQs reiterate the importance of such role in several respects.

The FAQs state that foreign broker-dealers may, if required by local law, send confirmations directly to their U.S. customers with whom they have conducted solicited business under Rule 15a-6(a)(iii). However, even if the foreign broker-dealer sends such confirmations, the Chaperoning Broker is still responsible for ensuring that the U.S. customer receives a confirmation that conforms with U.S. requirements such as Rule 10b-10 promulgated under the Exchange Act. In addition, the Chaperoning Broker will be responsible for maintaining account records that comply with SEC Rules 17a-3 and 17a-4 promulgated under the Exchange Act. Finally, for net capital purposes, the Chaperoning Broker must treat the chaperoned account as its own customer account, maintaining the proper net capital levels and taking charges for failed transactions in carried accounts. Generally, Chaperoning Brokers will be required to maintain minimum net capital of at least $250,000, unless the Chaperoning Broker is clearing its transactions through another broker on a fully disclosed basis or unless the Chaperoning Broker's activities are limited to M&A advisory matters.

Conclusion

While the FAQs represent continued progress, Rule 15a-6 continues to impose limitations which are out-of-step with the globalized nature of financial markets. In June 2008, the SEC proposed a much more significant revision of Rule 15a-6 which would have permitted foreign broker-dealers direct access to a wider segment of the U.S. investor community and would have eliminated many of the chaperoning requirements.[6] Unfortunately, this proposal came out only a few months before the collapse of Lehman Bros. and the resulting crisis in the financial markets which dominated the SEC's agenda for the next several years. As the SEC looks forward, we hope they will recognize the need for enhancing access by U.S. investors to well-regulated foreign broker-dealers.

[6] Release No. 34-58047.

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