

The Extra-territorial Reach of the Broker-Dealer Registration Requirements Under the U.S. Securities Exchange Act of 1934; *the Staff of the Securities and Exchange Commission Addresses Frequently Asked Questions Regarding Rule 15a-6 and Foreign Broker-Dealers*

I. Background.

Rule 15a-6 under the Securities Exchange Act of 1934 (“Rule 15a-6”) provides conditional exemptions from broker-dealer registration for “foreign broker-dealers”¹ that engage in certain specified activities involving U.S. investors (“Rule 15a-6 Activities”).

Rule 15a-6 activities include:

- A. Effecting unsolicited securities transactions;
- B. Providing research reports to “Major U.S. Institutional Investors,”² and effecting transactions in the subject securities with or for those investors;
- C. Soliciting and effecting transactions with or for “U.S. Institutional Investors”³ or “Major U.S. Institutional Investors” through a “chaperoning broker-dealer;” and
- D. Soliciting and effecting transactions with or for registered broker-dealers, banks⁴ acting in a broker or dealer capacity, certain international organizations, foreign persons temporarily present in the U.S., U.S. citizens resident abroad, and foreign branches and agencies of U.S. persons.

In the past, the Staff of the Division of Trading and Markets (the “Staff”) of the Securities and Exchange Commission (“SEC”) has provided guidance regarding Rule 15a-6 through responses to requests for no-action relief (*see, e.g.*, the “Seven Firms Letter” and the “Nine Firms Letter” (collectively, the “Letters”)) and certain frequently asked questions.⁵ More recently, in June 2008, the SEC proposed to amend Rule 15a-6 to provide securities market participants improved access to foreign securities markets and the expertise of foreign broker-dealers (the “Proposed Rule Amendment”).⁶ The Proposed Rule Amendment, although welcomed by market participants, was overtaken by the financial crises and has not adopted.

On March 21, 2013, the Staff supplemented its prior guidance with responses to 16 additional frequently asked questions (collectively, the “New Responses”). In his presentation to the American Bar Association, Trading and Markets Subcommittee on April 5, 2013, David W. Blass, Chief Counsel, Division of Trading and Markets of the SEC⁷ referred to the New Responses “as an initial set of staff guidance about issues that commonly arise under Rule 15a-6 [that] do not break new ground.” He added that we “are very much open to exploring opportunities for additional guidance through subsequent FAQs.” With regard to the prospects for an amendment to Rule 15a-6 Mr. Blass stated:

We also have had broader discussions with many of you about Rule 15a-6, including whether there are opportunities to more fundamentally update the rule, which was adopted in 1989 when the globalization of the securities markets was just emerging. I approach this topic with an open mind, and also a belief that Rule 15a-6 should be complementary to – though not necessarily identical to – the cross-border approach that the SEC may take with respect to the security-based swaps market.⁸

II. The New Responses.

The New Responses address a variety of frequently asked questions, some of which were addressed, at least in part, in the Proposed Rule Amendment. The following is a summary of the more significant issues.⁹

A. The Status of a Foreign Person Who is in the United States for a Finite Period of Time (Question 1).

Paragraph (a)(4)(iii) of Rule 15a-6 provides an exemption from registration under the Securities Exchange Act of 1934 (the “Exchange Act”) for a foreign broker-dealer to the extent that it:

effects transactions in securities with or for, or induces or attempts to induce the purchaser of sale of any security by . . . a foreign person temporarily present in the United States, with whom the foreign broker or dealer had a bona fide, pre-existing relationship before the foreign person entered the United States.

The Staff noted that in the Release adopting Rule 15a-6¹⁰ (the “Adopting Release”) that a foreign person not otherwise deemed a resident of the United States under applicable law would be presumed to be temporarily present in the United States. The scope of the exemption, however, would not extend to a person who is a U.S. citizen or a lawful permanent resident of the United States (*i.e.*, a “Green Card holder”).

The Proposed Rule Amendment did not address this issue. However, it does include a provision that would add to the list of persons with whom a foreign broker-dealer can effect transactions under the exemption “any U.S. person, other than a registered broker-dealer or a bank acting pursuant to an exception or exemption from the definition of ‘broker’ or ‘dealer,’ that acts in a fiduciary capacity for an account of a ‘foreign resident client.’”¹¹

B. Direct Distribution by a Foreign Broker-Dealer of Research Reports to Major U.S. Institutional Investors Without Any Involvement of a Registered Broker-Dealer (Question 5).

The Staff stated that paragraph (a)(2) Rule 15a-6, which permits a foreign broker-dealer to furnish research reports to Major U.S. Institutional Investors and to effect transactions in the securities discussed in the reports with or for those investors, if certain conditions

are satisfied,¹² does not require that the distribution be made by a registered broker-dealer even if the foreign broker-dealer has a chaperoning relationship with a registered broker-dealer. Also, the chaperoning broker-dealer would not have any obligations with respect to a research report if it was not involved in the distribution. However, if the foreign broker-dealer has a chaperoning relationship with a registered broker-dealer in compliance with paragraph (a)(3) of Rule 15a-6, any transactions with a foreign broker-dealer in securities discussed in the research report must be effected through the chaperoning broker-dealer in compliance with the requirements thereof.

The Proposed Rule Amendment would provide greater relief to foreign broker-dealers by allowing them to lessen their dependence on a chaperoning arrangement with a registered broker-dealer if certain conditions are satisfied. For example, if a foreign broker-dealer conducts a “foreign business”¹³ it would be permitted to effect all aspects of a solicited securities transaction with “qualified investors,” as defined in Section 3(a)(54) of the Exchange Act¹⁴, and any U.S. person that acts in a fiduciary capacity for an account of a “foreign resident client,” subject to certain conditions.

C. Reliance on the Letters; Foreign Broker-Dealers that Are Not Affiliated with a Registered Broker-Dealer (Questions 6, 7 and 8).

In the Letters the Staff took no-action positions with respect to certain activities proposed to be taken by foreign broker-dealers that were affiliated with registered broker-dealers.¹⁵ In the New Responses, the Staff stated that, although these no-action positions were based upon the particular facts and conditions presented, which included affiliation between the foreign broker-dealers and the registered broker-dealers, it considers the positions taken to apply also to a foreign broker-dealer that has a chaperoning arrangement with an unaffiliated registered broker-dealer.

The Staff also stated that its expanded view of the term “Major Institutional Investor,” as set forth in the Nine Firms Letter, applies to every provision of Rule 15a-6 in which that term is used.¹⁶ The Proposed Rule Amendment would replace the categories of “U.S. Institutional Investor” and “Major U.S. Institutional Investor” with the category of “Qualified Investor.”

D. Execution of Unsolicited Securities Transactions on Behalf of a Single U.S. Investor (Question 9).

Paragraph (a)(1) of Rule 15a-6 provides an exemption for a foreign broker-dealer to the extent that it: “effects transaction in securities with or for persons that have not been solicited by the foreign broker or dealer” The Staff stated that it:

would not ordinarily view a single securities transaction effected by a foreign broker-dealer on behalf of a U.S. investor in accordance with Rule 15a-6(a)(1) as precluding such foreign broker-dealer from relying on that same authority to effect one or more additional unsolicited securities

transactions on behalf of the same U.S. investor, absent any other indicia of solicitation.

The Staff hastened to add, however, that the SEC “takes a broad view of what constitutes solicitation” and that the Staff “would view a series of frequent transactions or a significant number of transactions between a foreign broker-dealer and a U.S. investor as being indicative of solicitation through the establishment of an ‘ongoing securities business relationship.’”

The Staff further noted that in the Adopting Release, the SEC provided examples of conduct that it would consider to be solicitation by a foreign broker-dealer, including:

- “Telephone calls from a broker-dealer to a customer encouraging use of the broker-dealer to effect transactions;
- Advertising directed into the U.S. of one's function as a broker or a market maker; and
- Recommending the purchase or sale of particular securities, with the anticipation that the customer will execute the recommended trade through the broker-dealer.”

These qualifications and examples naturally have had a chilling effect on foreign broker-dealers considering reliance on paragraph (a)(1) of the rule.

The Proposed Rule Amendment did not address this issue.

E. Net Capital Requirements (Questions 10 through 15).

Six of the New Responses concern the minimum net capital requirements for a registered broker-dealer under Rule 15c3-1 of the Exchange Act (the “Net Capital Rule”) that has entered into a chaperoning arrangement with a foreign broker-dealer pursuant to paragraph (a)(3) of Rule 15a-6. These scenarios address the most basic form of relationship and several other more complex situations.

In the base case, the Staff stated that the minimum net capital of the registered broker-dealer would be at least \$ 250,000, unless the broker-dealer has entered into a fully disclosed carrying agreement with another registered broker-dealer that has agreed to comply with the SEC’s applicable broker-dealer financial responsibility rules, in which case the minimum net capital requirement of the chaperoning broker-dealer would be \$5,000, or such greater amount that might be required based upon the broker-dealer’s activities. Other scenarios addressed include the case where the foreign broker-dealer’s business under Rule 15a-6 is limited to M&A advisory services to a U.S. counterparty or a non-U.S. counterparty contemplating the acquisition of a company, and the case in which the registered broker-dealer acts as a chaperone for DVP/RVP transactions with institutional investors.

The Proposed Rule Amendment does not specifically address the net capital requirements applicable to chaperoning broker-dealers, although it provides that a chaperoning broker-dealer would not be subject to, among other things, net capital obligations under the Net Capital Rule in the case of transactions with a foreign broker-dealer that conducts a “foreign business.”

III. Concluding Observations.

The New Responses provide helpful guidance regarding the application of Rule 15a-6.

Nonetheless, in order to address the fundamental limitations of Rule 15a-6 that have become more pronounced as the global securities markets have become ever more integrated, an amendment to the rule remains necessary.

Similar issues are presented with respect to the extra-territorial reach of the Commodity Exchange Act, particularly as a result of the amendments made thereto by the Dodd-Frank Wall Street Reform and Consumer Protection Act that provide for the regulation of swaps. The Commodity Futures Trading Commission (“CFTC”) is in the process of finalizing guidance that addresses these issues based on the principle of “substituted compliance.”¹⁷ This principle recognizes that in certain circumstances it should not be necessary for the CFTC to subject the activities of regulated non-U.S. entities to overlapping U.S. regulation. This principle also is consistent with the concept of a “mutual recognition regulatory regime” that the SEC has studied and cited in support of the Proposed Rule Amendment.¹⁸ Hopefully, the CFTC rulemaking process, being carefully monitored by the SEC, will facilitate further positive actions by the SEC with respect to the regulation of foreign broker-dealers.

Please do not hesitate to contact the authors with any questions that might arise.

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¹ Rule 15a-6(b)(3) defines “foreign broker-dealer” to mean:

any non-U.S. resident person (including any U.S. 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 sections 3(a)(4) or 3(a)(5) of the [Exchange] Act.

² Paragraph (b)(4) of Rule 15a-6 defines the term “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 (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.

³ Paragraph (b)(7) of Rule 15a-6 defines the term “U.S. Institutional Investor” to mean:

a person that is: (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 (17 CFR 230.501(a)(1)); a private business development company defined in Rule 501(a)(2) (17 CFR 230.501(a)(2)); an organization described in section 501(c)(3) of the Internal Revenue Code, as defined in Rule 501(a)(3) (17 CFR 230.501(a)(3)); or a trust defined in Rule 501(a)(7) (17 CFR 230.501(a)(7)).

⁴ As explained in note 3 of the New Responses:

The term ‘bank’ is defined in Section 3(a)(6) of the Exchange Act to mean a bank directly regulated by U.S. state or federal bank regulators. Accordingly, a foreign bank is excluded from this terms except to the extent that the “foreign bank establishes a branch or agency in the United States that is supervised and examined by a federal or state banking authority and otherwise meets the requirements of section 3(a)(6).”

⁵ Most significantly, as discussed in the New Responses:

in a 1996 letter to counsel for seven registered broker-dealers, staff indicated that they would not recommend enforcement action to the SEC if a foreign broker-dealer affiliated with any of the firms named in the letter (each, a “U.S. Affiliated Foreign Broker-Dealer”) effected transactions in “Foreign Securities” (as defined therein) with a “U.S. Resident Fiduciary” (as defined therein) for “Offshore Clients” (as defined therein) without the U.S. Affiliated Foreign Broker-Dealer either registering with the SEC or effecting the transactions in accordance with Rule 15a-6. [See Letter re: Transactions in Foreign Securities by Foreign Brokers or Dealers with Accounts of Certain Foreign Persons Managed or Advised by U.S. Resident Fiduciaries from Catherine McGuire, Chief Counsel, Division of Market Regulation to Giovanni P. Prezioso, Cleary, Gottlieb, Steen & Hamilton, dated January 30, 1996 (the “Seven Firms Letter”).] The following year, the Staff informed counsel to nine registered broker-dealers (including all of the firms party to the Seven Firms Letter) that they would not recommend enforcement action to the SEC if any U.S. Affiliated Foreign Broker-Dealer (as modified to reflect the addition of two additional firms party to the letter) engaged in certain activities without the U.S. Affiliated Foreign Broker-Dealer either registering with the SEC as a broker-dealer or effecting the transactions in accordance with Rule

15a-6. [See Letter re: Securities Activities of U.S.-Affiliated Foreign Dealers from Richard R. Lindsey, Director, Division of Market Regulation to Giovanni P. Prezioso, Cleary, Gottlieb, Steen & Hamilton, dated April 9, 1997 (the “Nine Firms Letter”).] Among other things, the Nine Firms Letter:

1. Established an expanded interpretation of the definition of “major U.S. institutional investor” to include “any entity, including any investment adviser (whether or not registered under the Investment Advisers Act), that owns or controls (or, in the case of an investment adviser, has under management) in excess of \$100 million in aggregate financial assets,” subject to certain limitations set forth in the letter
...
3. Permitted foreign associated persons of a foreign broker-dealer, without the participation of an associated person of a chaperoning broker-dealer, to (i) engage in oral communications from outside the U.S. with U.S. institutional investors (that do not qualify as major U.S. institutional investors) where such communications take place outside of the trading hours of the New York Stock Exchange, so long as the foreign associated persons do not accept orders to effect transactions other than those involving Foreign Securities, and (ii) have in-person contacts during visits to the U.S. with major U.S. institutional investors (as such definition was expanded in the letter), so long as the number of days on which such in-person contacts occur does not exceed 30 per year and the foreign associated persons engaged in such in-person contacts do not accept orders to effect securities transactions while in the U.S.

In addition, staff has provided responses to certain frequently asked questions regarding the application of Regulation AC to research activities of foreign broker-dealers, including foreign broker-dealers that rely on the exemption from U.S. broker-dealer registration in Rule 15a-6(a)(2). [See Responses to Frequently Asked Questions Concerning Regulation Analyst Certification, available at <http://www.sec.gov/divisions/marketreg/mregacfaq0803.htm> .]

⁶ Exchange Act Release No. 58047, June 27, 2008. In summary, the proposed amendments would: (i) expand the categories of U.S. investors that a foreign broker-dealer (a “FBD”) may solicit and for which it can provide research and execution services; (ii) streamline the conditions under which a FBD may engage in these activities with certain U.S. investors; and (iii) significantly reduce the role that a U.S. broker-dealer must play in intermediating transactions effected by a FBD.

⁷ Speech, *A Few Observations in the Private Fund Space*, David W. Blass, Chief Counsel, Division of Trading and Markets of the U.S. Securities and Exchange Commission (April 5, 2013), available at: <http://www.sec.gov/news/speech/2013/spch040513dwg.htm>

⁸ See text accompanying note 16, *infra*.

⁹ In addition to those discussed in the text, other questions addressed include: (i) the ability of a foreign broker-dealer that administers a global employee stock option plan (“ESOP”) to transmit communications regarding the ESOP, and effect transactions in the foreign issuer’s securities, for U.S. employees of the foreign issuer or its U.S. subsidiary (Question 2); (ii) the ability of a foreign broker-dealer to send confirmations and account statements to U.S. investors (Questions 3 and 4); and (iii) the recordkeeping obligations that apply to a registered broker-dealer that has entered into a chaperoning agreement with a foreign broker-dealer (Question 16).

¹⁰ Exchange Act Release 34-27017, July 11, 1989.

¹¹ The Proposed Rule Amendment defines the term “foreign resident client” to mean:”

- (i) Any entity not organized or incorporated under the laws of the United States and not engaged in a trade or business in the United States for federal income tax purposes; (ii) Any natural person not a U.S. resident for federal income tax purposes; and (iii) Any entity not organized or incorporated under the laws of the United States 85 percent or more of whose outstanding voting securities are beneficially owned by persons in paragraphs (b)(4)(i) and (b)(4)(ii) of this section.

¹² Under paragraph (a)(2) of Rule 15a-6 a foreign broker-dealer (who does *not* have a chaperoning relationship with a registered broker-dealer that complies with the strict requirements of paragraph (a)(3) of the rule) may only furnish research reports to U.S. buy-side customers which are Major U.S. Institutional Investors and effect transactions in the securities discussed in the research reports if the following conditions are satisfied:

1. the research reports do not recommend the use of the foreign broker-dealer to effect trades in any security;
2. the foreign broker-dealer does not initiate contact with such Major U.S. 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 U.S. Institutional Investors; and
3. there can be no express or implied understanding that the Major U.S. Institutional Investors to whom the foreign broker-dealer furnishes research will direct commission income to the foreign broker-dealer (*e.g.*, a “soft dollar” arrangement).

Due to the broad scope of the conditions imposed by paragraph (a)(2) of Rule 15a-6 this provision is not of great utility.

¹³ Under the Proposed Rule Amendment a foreign broker-dealer would conduct a “foreign business” if, generally, 85% of its securities business, on a rolling two-year basis, with qualified investors, and U.S. fiduciaries effecting transactions for the account of “foreign resident clients,” is in transactions in “foreign securities.”

¹⁴ Section 3(a)(54) of the Exchange Act defines the term “qualified investor,” generally, to mean:

(i) any investment company registered . . . under section 8 of the Investment Company Act of 1940; (ii) any issuer eligible for an exclusion from the definition of investment company pursuant to section 3(c)(7) of the Investment Company Act of 1940; (iii) any bank . . . savings association . . . broker, dealer, insurance company . . . or business development company . . .; (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 . . . 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) of this subparagraph; (vii) any market intermediary exempt under section 3(c)(2) of the Investment Company Act of 1940; (viii) any associated person of a broker or dealer other than a natural person; (ix) any foreign bank . . .; (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 who 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.

¹⁵ See note 5, *supra*.

¹⁶ *Id.*

¹⁷ See CFTC Approves Proposed Interpretive Guidance on Cross-Border Application of the Swaps Provisions of the Dodd-Frank Act at <http://www.cftc.gov/PressRoom/PressReleases/pr6293-12>; and CFTC Approves Exemptive Order on Cross-Border Application of the Swaps Provisions of Dodd-Frank at <http://www.cftc.gov/PressRoom/PressReleases/pr6478-12>.

¹⁸ See Exchange Act Release No. 58047, June 27, 2008, at text accompanying n. 43.