Considerations for Broker-Dealers under Rule 15a-6

April 14, 2020

Supplemental Materials

1. Exchange Act Release No. 27017 (July 11, 1989), 54 FR 30013 (July 18, 1989).

2. Exchange Act Release No. 25801 (June 14, 1988), 53 FR 23645 (June 23, 1988).

3. Exchange Act Release No. 58047 (June 27, 2008), 73 FR 39182 (July 8, 2008).

4. Cleary, Gottlieb, Steen and Hamilton, March 24, 1997.

5. Bear, Stearns & Co. Inc.; CS First Boston corporation; CSFP Capital, Inc.; Goldman, Sachs & Co.; Lehman Brothers Inc.; Morgan Stanley & Co. Incorporated; and Salomon Brothers Inc, January 30, 1996.

length and not more than a 32-bit internal architecture are regarded as 16-bit systems for purposes of this restriction);

(d) A maximum CPU to memory bandwidth of less than 160 Mbit/s;

(e) A CPU bus architecture that does not support multiple bus masters; and

(f) The systems do not include controlled "related equipment" other than input/output control unit/disk drive combinations having all of the following characteristics—

(1) A "total transfer rate" not exceeding 10.3 Mbit/s;

(2) A total connected "net capacity" not exceeding 140 MByte; and

(3) A "total access rate" not exceeding 80 accesses per second with a maximum "access rate" of 40 accesses per second per drive.

Note: The decontrol does not affect microprocessor based personal computers that are:

(a) Ruggedized above a commercial/office environment;

(b) Highly portable computers (those that can be battery powered or other self contained form of power); or

(c) Stand-alone graphic workstations with characteristics equalling or exceeding the parameters in ECCN 1565A Advisory Note 9(a)(7) (i) and (iv).

Note: For the purposes of this decontrol, personal computers are defined as microprocessor based computers that are:

(a) Designed and advertised by the manufacturer for personal, home or business use; and

(b) Are normally sold through retail establishments.

Dated: July 13, 1989.

James M. LeMunyon,

Deputy Assistant Secretary for Export Administration.

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SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

[Release No. 34-27017, International Series Release No. 105; File No. S7-11-88]

RIN: 3235-AD27

Registration Requirements for Foreign Broker-Dealers

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Commission is adopting proposed Rule 15a-6, which provides exemptions from broker-dealer registration for foreign entities engaged in certain activities involving U.S. investors and securities markets. The final rule incorporates the proposed interpretive statement that the Commission issued for comment when proposing the rule. In another release also issued today, the Commission is soliciting further comment on the concept of recognition of foreign securities regulation as a substitute for U.S. registration of foreign broker-dealers.

EFFECTIVE DATE: August 15, 1989.

FOR FURTHER INFORMATION CONTACT: Robert L.D. Colby, Chief Counsel, (202) 272-2844, or John Polanin, Jr., Special Counsel, (202) 272-2848, Division of Market Regulation, or Thomas S. Harman, Chief Counsel, (202) 272-2030, Division of Investment Management (regarding investment adviser registration requirements discussed in Part IV), Securities and Exchange Commission, 450 Fifth Street NW Washington, DC 20549.

SUPPLEMENTARY INFORMATION:

I. Executive Summary

The Commission is adopting proposed Rule 15a-6 to provide conditional exemptions from broker-dealer registration for foreign broker-dealers that engage in certain activities involving U.S. investors and securities markets. These activities include (i) "nondirect" contacts by foreign broker-dealers with U.S. investors and markets, through execution of unsolicited securities transactions, and provision of research to certain U.S. institutional investors; and (ii) "direct" contacts, involving the execution of transactions through a registered broker-dealer intermediary with or for certain U.S. institutional investors, and without this intermediary with or for registered broker-dealers, banks acting in a broker or dealer capacity, certain international organizations, foreign persons temporarily present in the United States, U.S. citizens resident abroad, and foreign branches and agencies of U.S. persons. The Commission's goals in adopting Rule 15a-6 at this time are (i) to facilitate access to foreign markets by U.S. institutional investors through foreign broker-dealers and the research that they provide, consistent with maintaining the safeguards afforded by broker-dealer registration; and (ii) to provide clear guidance to foreign broker-dealers seeking to operate in compliance with U.S. broker-dealer registration requirements.

In addition, the Commission is withdrawing the interpretive statement that it proposed together with Rule 15a-6. The final rule ("Rule") includes exemptions incorporating many of the positions originally set forth in the proposed interpretive statement. The Commission has included in this release a discussion of the purposes and scope of broker-dealer regulation and the general principles of U.S. registration for international broker-dealers, in order to emphasize the importance that the Commission attaches to broker-dealer registration and regulation in the international context.

Finally, the Commission has issued a separate release discussing the concept of an exemption from broker-dealer registration based on recognition of foreign regulation. Many commenters addressing the proposed rule favored this approach, but the Commission believes that the numerous complex issues raised by this approach require further exploration before any action is taken on the concept. To clarify the application of U.S. broker-dealer registration requirements to the cross-border activities of foreign broker-dealers, the Commission is adopting the Rule now, while soliciting more detailed comments on the parameters of the concept of an exemption from broker-dealer registration based on recognition of foreign securities regulation.

II. Introduction

Rule 15a-6 is based on the Commission's recognition of the fact that the pace of internationalization in securities markets around the world continues to accelerate.[1] As the Commission noted when it published Rule 15a-6 for comment,[2] multinational offerings of securities have become frequent,[3] and linkages are developing between secondary markets[4] and

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In its recent *Policy Statement on Regulation of International Securities Markets*, the Commission outlined its views on the appropriate regulatory response to this development, which it broadly described as facilitating efficient and honest markets where investors and issuers can seek the greatest return on investment and the lowest cost of capital, without regard for national boundaries. Securities Act Release No. 6807 (Nov. 14, 1988), 53 FR 46963.

Securities Exchange Act Release No. 25801 (June 14, 1988), 53 FR 23645, 23648 ("Release 34-25801").

See Internationalization of the Securities Markets, Report of the Staff of the U.S. Securities and Exchange Commission to the Senate Committee on Banking, Housing, and Urban Affairs and the House Committee on Energy and Commerce (July 27, 1987) ("Report on Internationalization") at III-43 to III-53.

Since 1985, the Commission has approved several linkages between U.S. and foreign exchanges, including the link between the Montreal Stock Exchange and the Boston Stock Exchange, and the links between the Toronto Stock Exchange and the American and Midwest Stock Exchanges, respectively. *See* Report on Internationalization at V-49 to V-57 Presently, only the Montreal Stock

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clearing systems.[5] The desire of investors to trade in financial markets around the world is increasing steadily, and many major institutional investors, particularly investment companies, insurance companies, pension funds, and large commercial banks, are active on an international basis.[6]

As interest in foreign securities has grown, the geographical reach of intermediaries based in national markets has expanded greatly. Many U.S. and foreign broker-dealers are developing an international securities business, establishing offices throughout the world.[7] According to statistics compiled by the Commission's Office of Economic Analysis, 179 registered U.S. broker-dealers were affiliated with foreign broker-dealers or foreign banks as of 1987 In contrast, in 1973 there were approximately twenty-eight non-Canadian U.S. broker-dealers with foreign parents.[8] As of 1988, there were approximately fifty members of the New York Stock Exchange in which foreign entities had an ownership interest. In 1973, there were four.[9]

Exchange/Boston Stock Exchange linkage is in operation. In addition, the Commission has approved pilot program developed by the National Association of Securities Dealers, Inc. ("NASD") and the International Stock Exchange of the United Kingdom and the Republic of Ireland, Ltd. ("ISE"), linking the NASD's automated quotations system ("NASDAQ") and the ISE's electronic quotation system ("SEAQ"). Securities Exchange Act Release No. 23158 (Apr. 21, 1986), 51 FR 15989. The pilot program has been extended to October 2, 1989. Securities Exchange Act Release No. 24979 (Oct. 2, 1987), 51 FR 37684. The Commission also has approved a pilot program providing for an exchange of quotations between NASDAQ and the Stock Exchange of Singapore. Securities Exchange Act Release No. 25457 (Mar. 14, 1988), 53 FR 9156.

E.g., Letter from Jonathan Kallman, Assistant Director, Division of Market Regulation, SEC, to Karen L. Saperstein, Esq., Associate General Counsel, International Securities Clearing Corporation ("ISCC") (Sept. 20, 1988) (ISCC linkage with Japan Securities Clearing Corporation).

Greenwich Associates, *Institutional Investors 1989*, 9–12, 72–87.

One commentator recently estimated that approximately thirty broker-dealers will possess the integrated back-office trading and management information systems necessary to execute and clear securities transactions on global basis by the year 2000. Kraus, *Growth Predicted in Global Traders*, American Banker, Mar. 20, 1989, at 14.

New York Stock Exchange Advisory Committee on International Capital Markets, *Recommendations Regarding Foreign Access to the U.S. Securities Markets* (July 1973), Appendix B.

Id. at 12.

The Commission responded to this international expansion in broker-dealer activities by publishing Release 34–25801. This release had two purposes. First, as discussed at greater length below, the Commission sought to make known the existing U.S. requirements for registration of foreign broker-dealers. Second, the Commission sought to facilitate investment by U.S. institutional investors in foreign securities markets by proposing a rule that would increase access to foreign broker-dealers, consistent with the investor safeguards afforded by broker-dealer regulation. The Commission recognized that foreign broker-dealers can provide valuable market experience, trade execution, and research services to U.S. institutions interested in entering overseas markets.

Release 34–25801 comprised an interpretive statement and a proposed rule. The interpretive statement was a summary of the staff's current positions regarding broker-dealer registration by foreign entities. Proposed Rule 15a-6, developed from past interpretive, no-action, and exemptive positions, would have exempted from the broker-dealer registration requirements of section 15(a) of the Securities Exchange Act of 1934 ("Exchange Act") [10] foreign broker-dealers that engaged in securities transactions with certain non-U.S. persons or with specified U.S. institutional investors under limited conditions.

Subsequently, members of the Committee on Federal Regulation of Securities of the Section of Business Law of the American Bar Association ("ABA") submitted a comment letter suggesting an expanded version of proposed Rule 15a–6, which generally reflected the substance of the interpretive statement. The ABA suggested that an expanded rule, among other things, would "spell out clearly in one place the ground rules to which foreign broker-dealers are subject" and be "more consistent with orderly development of the law in this area. [11]

[10] 15 U.S.C. 78o(a).

[11] Letter from John M. Liftin, Esq., Committee on Federal Regulation of Securities, Section of Business Law, ABA, to Jonathan G. Katz, Secretary, SEC (Sept. 14, 1988).

Believing that expansion of proposed Rule 15a–6 to include additional portions of the interpretive statement deserved "serious consideration, the Commission solicited comment on an expanded rule.[12]

The Commission received thirty-two comment letters in response to proposed Rule 15a–6 and the interpretive statement.[13] The commenters generally supported the Commission's goal of facilitating access to foreign markets by U.S. institutional investors, consistent with the purposes underlying broker-dealer registration. Commenters also generally supported expansion of the proposed rule to include the substance of the interpretive statement.

III. Broker-Dealer Regulation

A. Purposes and Scope of Broker-Dealer Regulation

In the context of adopting exemptions from the U.S. broker-dealer regulatory scheme, the Commission believes that it is important to reiterate the fundamental significance of broker-dealer registration within the structure of U.S. securities market regulation. Because of the broker-dealer's role as an intermediary between customers and the securities markets, broker-dealers have been required to register with the Commission since 1935,[14] and they were registered with numerous states before enactment of the Exchange Act in 1934.[15] The definitions in the Exchange Act of the

[12] Securities Exchange Act Release No. 26136 (Sept. 30, 1988), 53 FR 38967 ("Release 34–26136").

[13] A detailed comment summary has been prepared and placed in the Commission's public files, together with all comment letters received. *See* File No. S7–11–88.

[14] As originally enacted, the Exchange Act dealt primarily with exchange regulation, and section 15 of the Exchange Act authorized the Commission to provide, by rule, for registration of brokers or dealers that were not already exchange members. After the Commission initially adopted rules requiring registration of over-the-counter broker-dealers, Congress in 1936 amended section 15 to codify the Commission's rules on broker-dealer registration. *See* L. Loss, *Fundamentals of Securities Regulation* 409–10 (1988) and the concept release also issued today, *infra* note 34.

[15] *See generally* L. Loss & E. Cowett, *Blue Sky Law* 26–30 (1958).

terms "broker" [16] and "dealer" [17] and the registration requirements of section 15(a) of the Exchange Act [18] were drawn broadly by Congress to encompass a wide range of activities involving investors and securities markets.[19] Section 15(a) of the Exchange Act generally requires that any broker or dealer using the mails or any means or instrumentality of interstate commerce (referred to as the jurisdictional means) [20] to induce or effect transactions in securities [21] must register as a broker-dealer with the Commission.

Registered broker-dealers are subject to a panoply of U.S. regulations and supervisory structures intended to protect investors and the securities markets.[22] Registered broker-dealers must be members of a self-regulatory organization ("SRO") [23] and the Securities Investor Protection Corporation ("SIPC").[24] They are subject to statutory disqualification standards and the Commission's disciplinary authority,[25] which are designed to prevent persons with an adverse disciplinary history from becoming, or becoming associated with, registered broker-dealers. They also are required by the Commission's net capital regulations [26] to maintain sufficient capital to operate safely. In addition, they are required to maintain adequate competency levels, by satisfying SRO qualification requirements.[27]

Further, registered broker-dealers are under extensive recordkeeping and reporting obligations,[28] fiduciary duties [29] and special antifraud rules,[30] and the Commission's broad enforcement authority over broker-dealers.[31] That authority, in turn, helps assure that broker-dealers are complying with the statutory and regulatory provisions governing the U.S. securities industry.[32] Moreover, the

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[16] Section 3(a)(4) of the Exchange Act defines "broker" as "any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank. 15 U.S.C. 78c(a)(4). The term "bank, however, is limited by section 3(a)(6) of the Exchange Act, 15 U.S.C. 78c(a)(6), to banks directly regulated by U.S. state or federal bank regulators, and thus foreign banks that act as brokers or dealers within the jurisdiction of the United States are subject to U.S. broker-dealer registration requirements. *See* Release 34-25801, 53 FR at 23645 n.1. To the extent, however, that a 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), the Commission would consider this branch or agency to be a "bank" for purposes of sections 3(a)(4) and 3(a)(5) of the Exchange Act.

The Commission believes that the determination whether any particular financial institution meets the requirements of section 3(a)(6) is the responsibility of the financial institution and its counsel. *Cf.* Securities Act Release No. 6661 (Sept. 23, 1986), 51 FR 34460 ("Release 33-6661") (determination as to whether branch or agency of foreign bank falls within the definition of "bank" under section 3(a)(2) of Securities Act of 1933 ("Securities Act"), 15 U.S.C. 77c(a)(2), is responsibility of issuers and their counsel). The Commission notes, however, that section 4(d) of the International Banking Act, 12 U.S.C. 3102(d), expressly prohibits agencies of foreign banks established under federal law from receiving deposits or exercising fiduciary powers, criteria necessary for qualification as a bank under section 3(a)(6)(C). *See Conference of State Bank Supervisors* v. *Conover*, 715 F.2d 604 (D.C. Cir. 1983), *cert. denied*, 466 U.S. 927 (1984) (federally-chartered agencies of foreign banks prohibited from receiving deposits from foreign, as well as domestic, sources). It also should be noted that the definition of bank under section 3(a)(6) of the Exchange Act differs somewhat from the definition of bank under section 3(a)(2) of the Securities Act, particularly with respect to exercising fiduciary powers and receiving deposits. As discussed *infra* note 168, the Securities Act definition is applicable in determining whether U.S. branches and agencies of foreign banks qualify as U.S. institutional investors under the Rule.

[17] Section 3(a)(5) of the Exchange Act, 15 U.S.C. 78c(a)(5), defines "dealer" as "any person engaged in the business of buying and selling securities for his own account, through broker or otherwise, but does not include a bank, or any person insofar as he buys and sells securities for his own account, either individually or in some fiduciary capacity, but not as a part of a regular business. Although by its terms this definition is broad, it has been interpreted to exclude various activities not within the intent of the definition, such as buying and selling for investment. *See, e.g.*, Letter from Robert L.D. Colby, Chief Counsel, Division of Market Regulation, SEC, to Elizabeth J. Tolmach, Esq., Caplin & Drysdale (Apr. 2, 1987) (United Savings Association of Texas) (no-action position on government securities dealer registration). In addition, the registration requirements of section 15(a) of the Exchange Act exclude from registration additional categories of persons, such as intrastate broker-dealers. *Cf.* Douglas & Bates, *Some Effects of the Securities Act Upon Investment Banking*, 1 U. Chi. L. Rev. 283, 302 n.68 (1934); Douglas & Bates, *The Federal Securities Act of 1933*, 43 Yale L.J. 171, 206 n.189 (1933) ("rule of reason should apply to similarly broad "dealer" definition in section 2(12) of Securities Act, 15 U.S.C. 77b(12)).

[18] *See supra* note 10.

[19] For instance, if a U.S. issuer sells its securities in the United States through its own employees, the activities of these employees may require broker-dealer registration. This is also true for foreign issuers using their employees to sell securities within the United States. However, the Commission has adopted Rule 3a4-1, 17 CFR 240.3a4-1, which provides a safe-harbor exemption from broker-dealer registration for an issuer's personnel selling the issuer's securities under certain circumstances. *See* Securities Exchange Act Release No. 22172 (June 27, 1985), 50 FR 27940.

[20] Specifically, section 15(a)(1), 15 U.S.C. 78*o*(a)(1), refers to "use of the mails or any means or instrumentality of interstate commerce to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security (other than an exempted security or commercial paper, bankers' acceptances, or commercial bills) Given the broad definition of "interstate commerce" in section 3(a)(17) of the Exchange Act, 15 U.S.C. 78c(a)(17), which includes "trade, commerce, transportation, or communication between any foreign country and any State, virtually any transaction-oriented contact between a foreign broker-dealer and the U.S. securities markets or a U.S. investor in the United States involves interstate commerce and could provide the jurisdictional basis for broker-dealer registration.

[21] Section 15(a) does not require registration for transactions in exempted securities, which are defined in section 3(a)(12) of the Exchange Act, 15 U.S.C. 78c(a)(12), commercial paper, bankers' acceptances, and commercial bills. 15 U.S.C. 78*o*(a)(1). The Canadian Bankers' Association asked the Commission to clarify that the U.S. broker-dealer registration requirements do not apply to transactions in U.S. commercial paper by Canadian banks in the U.S. market. Commercial paper, bankers' acceptances, and commercial bills are not defined in the Exchange Act. Nonetheless, the Commission notes that the definition of "security" in section 3(a)(10) of the Exchange Act, 15 U.S.C. 78c(a)(10), generally is understood to exclude instruments exempt from registration under section 3(a)(3) of the Securities Act, 15 U.S.C. 77c(a)(3), by virtue of their classification as commercial paper. *See* Securities Exchange Act Release No. 4412 (Sept. 20, 1961) [1957-61 Transfer Binder], Fed. Sec. L. Rep. (CCH) ¶ 2045 (factors identifying exempted commercial paper under section 3(a)(3) of Securities Act); *Sanders* v. *John Nuveen & Co.*, 463 F.2d 1075 (7th Cir.), *cert. denied*, 409 U.S. 1009 (1972) (applying same factors under section 3(a)(10) of Exchange Act).

[22] Many of the statutory and regulatory provisions cited below as applicable to registered broker-dealers actually are applicable by their terms to other unregistered broker-dealers. *E.g.*, sections 15(b)(4) and 15(b)(6) of the Exchange Act, 15 U.S.C. 78*o*(b)(4) and 78*o*(b)(6); Rules 15c3-1, 15c3-3, 17a-3, 17a-4, and 17a-5, 17 CFR 240.15c3-1, 15c3-3, 17a-3, 17a-4, and 17a-5. Nevertheless, the staff would not recommend that the Commission take enforcement action against foreign broker-dealers for want of compliance with those provisions, with the exception of sections 15(b)(4) and 15(b)(6), if the foreign broker-dealers were exempt from broker-dealer registration under the Rule.

[23] Section 15(b)(8) of the Exchange Act, 15 U.S.C. 78*o*(b)(8).

[24] Section 3(a)(2) of the Securities Investor Protection Act of 1970, 15 U.S.C. 78ccc(a)(2).

[25] *See* sections 3(a)(39), 15(b)(4), and 15(b)(6) of the Exchange Act, 15 U.S.C. 78c(a)(39), 78*o*(b)(4), and 78*o*(b)(6).

[26] *See* Rule 15c3-1, 17 CFR 240.15c3-1.

[27] *E.g.*, NASD Schedules to By-Laws, Schedule C, *NASD Manual* (CCH) ¶¶1782-91. *See* section 15(b)(7) of the Exchange Act, 15 U.S.C. 78*o*(b)(7).

[28] *E.g.*, Rules 17a-3 (recordkeeping), 17a-4 (record preservation), and 17a-5 (reporting), 17 CFR 240.17a-3, 17a-4, and 17a-5. In addition, for nonresident registered broker-dealers the Commission has adopted Rule 17a-7, which establishes requirements for U.S. maintenance of records by these broker-dealers. 17 CFR 240.17a-7. *See also* NASD Schedules to By-Laws, Schedule C (VIII), *NASD Manual* (CCH) ¶1790.

[29] *See Hanly V. SEC*, 415 F.2d 589, 596 (2d Cir. 1969) ("A securities dealer occupies a special relationship to a buyer of securities in that by his position he implicitly represents he has an adequate basis for the opinions he renders").

[30] *E.g.*, section 15(c) of the Exchange Act, 15 U.S.C. 78*o*(c), and the rules thereunder, *e.g.*, Rule 15c1-2, 17 CFR 240.15c1-2.

[31] *See* sections 15(c) and 21 of the Exchange Act, 15 U.S.C. 78*o*(c) and 78u.

[32] *E.g.*, Rule 14b-1, 17 CFR 240.14b-1 (prompt forwarding of proxy information to beneficial owners of securities); Rule 17a-8, 17 CFR 240.17a-8 (financial recordkeeping and reporting of currency and foreign transactions); Rule 17a-13, 17 CFR

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Commission's financial supervision of entities participating in the interdependent network of securities professionals contributes to the financial soundness of this nation's securities markets.

These considerations remain important regardless of whether a broker-dealer's activities involve contacts with individual or institutional investors. When Congress authorized and subsequently required the Commission to register broker-dealers, Congress did not condition the requirement for registration on the type of investor involved. In 1975, Congress amended section 15(a) to extend the broker-dealer registration requirements to all broker-dealers trading exclusively on a national securities exchange or in municipal securities.[33] Moreover, as noted in the concept release issued today,[34] Congress recently reaffirmed the importance of regulating securities professionals who operated in a largely institutional market by enacting the Government Securities Act of 1986.[35] Congress enacted this legislation to remedy serious problems, including a depositors' run on savings and loan associations and savings banks that resulted in the temporary closing of seventy-one of those financial institutions, that had developed in a primarily institutional market due in part to inadequate regulation of the professional intermediaries in that market.[36]

Accordingly, after reviewing the comments, the Commission is proceeding cautiously by adopting the limited exemptions incorporated in the Rule. As discussed previously, however, the Commission is seeking comment in the Concept Release on a conceptual approach that might increase the ability of U.S. institutional investors to deal with foreign broker-dealers in a manner that is consistent with the protection of those investors and with the Exchange Act.

B. General Principles of U.S. Registration for International Broker-Dealers

Before discussing the exemptions in the Rule, it is useful to review the general principles governing U.S. registration of brokers and dealers engaging in international activities.[37] The definitions of "broker" [38] and "dealer" [39] do not refer to nationality, and the scope of these definitions includes both domestic and foreign persons [40] performing the activities described therein. Consequently, any use of the U.S. jurisdictional means to engage in these activities could trigger the broker-dealer registration requirements of section 15(a).[41]

1. Broker-Dealer Operations

As a policy matter, the Commission now uses a territorial approach in applying the broker-dealer registration requirements to the international operations of broker-dealers.[42] Under this approach, all broker-dealers physically operating within the United States that effect, induce, or attempt to induce any securities transactions would be required to register as broker-dealers with the Commission, even if these activities were directed only to foreign investors outside the United States. Conversely, as explained in the interpretive statement in Release 34-25801, U.S. entities would not be required to register if they conducted their sales activities entirely outside the United States.[43]

240.17a-13 (quarterly security counts); Rule 17f-1, 17 CFR 240.17f-1 (reports and inquiries concerning missing, lost, counterfeit, or stolen securities); Rule 17f-2, 17CFR 240.17f-2 (fingerprinting of securities industry personnel).

[33] Securities Act Amendments of 1975, Pub. L. No. 94-29, § 11, 89 Stat. 97, 121 (1975).

[34] Securities Exchange Act Release No. 27018 (July 11, 1989) ("Concept Release").

[35] Pub. L. No. 99-571, 100 Stat. 3208 (1986).

[36] *See* S. Rep. No. 99-426, 99th Cong., 2d Sess. 6-10 (1986).

[37] These principles similarly would apply to registration of government securities brokers or government securities dealers under section 15C of the Exchange Act, 15 U.S.C. 78o-5, and to registration of municipal securities dealers under section 15B of the Exchange Act, 15 U.S.C. 78o-4. Neither these principles nor the Rule, however, necessarily reflect the requirements of any state securities laws, which may apply to the activities of foreign broker-dealers within the jurisdiction of those states. Foreign broker-dealers exempt from registration by virtue of compliance with the Rule still could be subject to the registration requirements established by state securities laws, since the Commission has no authority to grant exemptions from those requirements.

[38] *See* note 16 *supra*.

[39] *See* note 17 *supra*.

[40] Section 3(a)(9) of the Exchange Act, 15 U.S.C. 78c(a)(9), defines "person" as a "natural person, company, government, or political subdivision, agency, or instrumentality of a government, again without reference to nationality.

[41] *See supra* note 20 and accompanying text. Apart from concerns about broker-dealer registration, foreign broker-dealers should be careful that any offers or sales of securities comply with the registration provisions of the Securities Act, when applicable. *See* Securities Act Releases No. 4708 (July 9, 1964), 29 FR 9828 ("Release 33-4708"), and No. 6779 (June 10, 1988), 53 FR 22661 ("Release 33-6779").

A potential limitation on the broad application of section 15(a) may be found in section 30(b) of the Exchange Act, which excludes from the application of the Exchange Act or the rules thereunder any person "transact[ing] a business in securities without the jurisdiction of the United States, in the absence of Commission rules explicitly applying those provisions to these persons. 15 U.S.C. 78dd(b). While no rules have been adopted, the exemption provided by section 30(b) has been held unavailable if transactions occur in a U.S. securities market, *Roth v. Fund of Funds, Ltd.*, 405 F.2d 421 (2d Cir. 1968), *cert. denied*, 394 U.S. 975, *reh. denied*, 395 U.S. 941 (1969); *Schoenbaum v. Firstbrook*, 405 F.2d 200, 208 (2d Cir.), *rev'd in part on other grounds*, 405 F.2d 215 (2d Cir. 1968) (en banc), *cert. denied sub nom. Manley v. Schoenbaum*, 395 U.S. 906 (1969); *Selzer v. The Bank of Bermuda, Ltd.*, 385 F. Supp. 415 (S.D.N.Y. 1974); *In the Matter of I.O.S., Ltd. (S.A.)*, [1971-72 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶78,637 (Mar. 14, 1972); if offers and sales are made abroad to U.S. persons or in the United States to facilitate sales of securities abroad, *SEC v. United Financial Group, Inc.*, 474 F.2d 354 (9th Cir. 1973); *Traves v. Anthes Imperial Ltd.*, 473 F.2d 515 (8th Cir. 1973); *Leasco Data Processing Equipment Corp. v. Maxwell*, 468 F.2d 1326, 1336 n.6 (2d Cir. 1972); *Bersch v. Drexel Firestone, Inc.*, 389 F. Supp. 446, 453-59 (S.D.N.Y. 1974), *aff'd in part and rev'd in part*, 519 F.2d 974 (2d Cir. 1975), *cert. denied sub nom. Bersch v. Arthur Andersen & Co.*, 423 U.S. 1018 (1975); or if the United States is used as base for securities fraud perpetrated on foreigners, *Arthur Lipper Corp. v. SEC*, 547 F.2d 171 (2d Cir. 1976), *reh. denied*, 551 F.2d 915 (2d Cir. 1977), *cert. denied*, 434 U.S. 1009 (1978).

In their comment letters, the College Retirement Equities Fund ("CREF"), Westpac Banking Corporation, and Debevoise & Plimpton argued that section 30(b) should exempt from Commission regulation foreign broker-dealers operating exclusively outside this country and contacting U.S. institutional investors in the United States from outside this country. They asserted that reading section 30(b) to protect only foreign broker-dealers not using the U.S. jurisdictional means to effect, induce, or attempt to induce any transactions in securities with or for U.S. persons would render the section meaningless, on the grounds that foreign broker-dealers avoiding this use of the U.S. jurisdictional means would not be subject to the requirements of section 15(a) in the first place.

The Commission's position on the application of section 30(b) historically has been, and continues to be, that the phrase "without the jurisdiction of the United States" in that section does not refer to the territorial limits of this country. *See, e.g.*, Securities and Exchange Commission, *Brief Amicus Curiae on Rehearing by the Full Court, Schoenbaum v. Firstbrook* (2d Cir. 1968) at 23. Moreover, even if section 30(b) were read to incorporate territorial approach, the Commission does not believe that section 30(b) would exempt from broker-dealer registration the activities suggested by the commenters. In particular, directed selling efforts to U.S. investors in the United States hardly could be considered activities not traversing the U.S. territorial limits. A broker-dealer operating outside the physical boundaries of the United States, but using the U.S. mails, wires, or telephone lines to trade securities with U.S. persons located in this country, would not be, in the words of section 30(b), "transact[ing] a business in securities without the jurisdiction of the United States.

[42] Proposed Regulation S also follows territorial approach, *see* Release 33-6779, 53 FR at 22665-66. This territorial approach is different from the limited nationality approach taken in Release 33-4708, which stated that, to avoid being subject to the registration requirements of the Securities Act, an offering must be "made under circumstances reasonably designed to preclude distribution or redistribution of the securities within, *or to nationals of*, the United States. 29 FR at 9829 (emphasis added).

[43] *See* Release 34-25801, 53 FR at 23646 n.9 and accompanying text. After the effective date of the Rule, the staff will withdraw two prior inconsistent no-action positions regarding arrangements under which sales or related activities involving exclusively foreign persons emanated from within this country. Letter from Amy Natterson Kroll,

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Also, the Commission uses an entity approach with respect to registered broker-dealers. Under this approach, if a foreign broker-dealer physically operates a branch in the United States, and thus becomes subject to U.S. registration requirements, the registration requirements and the regulatory system governing U.S. broker-dealers would apply to the entire foreign broker-dealer entity. If the foreign broker-dealer establishes an affiliate in the United States, however, only the affiliate must be registered as a broker-dealer; the foreign broker-dealer parent would not be required to register.[44] Under this arrangement, absent exemptions, only the registered U.S. affiliate would be authorized to trade with any person in the United States or perform securities functions on behalf of those customers, such as effecting trades, extending credit, maintaining records and issuing confirmations, and receiving, delivering, and safeguarding funds and securities.[45]

Some commenters questioned whether, under these principles, a registered broker-dealer's personnel who are stationed outside the United States with a foreign broker-dealer may contact U.S. and foreign persons located in the United States on behalf of the registered broker-dealer, provided that these personnel are U.S.-registered and subject to U.S. regulatory supervision.[46] Assuming these persons were subject to the registered broker-dealer's supervision and control [47] and satisfied all U.S. SRO qualification standards,[48] the Commission believes that it is consistent with these principles for a registered broker-dealer s registered representative stationed outside the United States with a foreign broker-dealer to contact persons in the United States from within or without this country on behalf of the registered broker-dealer.

2. U.S. Investors

In addition to requiring broker-dealer operations physically located within the United States to register, the Commission's territorial approach generally would require broker-dealer registration by foreign broker-dealers that, from outside the United States, induce or attempt to induce trades by any person in the United States.[49] The Commission would not require registration, however, of foreign broker-dealers dealing from abroad with foreign persons domiciled abroad but temporarily present in this country.[50]

If foreign broker-dealers are effecting trades outside the United States with or for individual U.S. citizens resident abroad, but have no other contacts within the jurisdiction of the United States, the Commission generally would not expect these foreign broker-dealers to register. Most U.S. citizens residing abroad typically would not expect, in choosing to deal with foreign broker-dealers, that these foreign broker-dealers would be subject to U.S. registration requirements. Nor would foreign broker-dealers soliciting U.S. citizens resident abroad normally expect that they would be covered by U.S. broker-dealer requirements, since they generally would not be directing their sales efforts toward groups of U.S. nationals. To make clear that registration is not required of foreign broker-dealers dealing with U.S. persons resident abroad, including branches and agencies of U.S. persons located abroad, the Commission has included in the Rule a specific exemption for these foreign broker-dealers, as discussed in greater detail below. The Commission historically has taken the view, however, that foreign broker-dealers specifically targeting identifiable groups of U.S. persons resident abroad, *e.g.*, U.S. military and embassy personnel, could be subject to U.S. broker-dealer registration requirements.[51] This position is reflected in the exemption.

3. Solicitation

The proposed interpretive statement explained that if a transaction with a person in the United States is solicited, the broker-dealer effecting the transaction must be registered.[52] Although the requirements of section 15(a) do not distinguish between solicited and unsolicited transactions, the Commission does not believe, as a policy matter, that registration is necessary if U.S. investors have sought out foreign broker-dealers outside the United States and initiated transactions in foreign securities markets entirely of their own accord. In that event, U.S. investors would have taken the initiative to trade outside the United States with foreign broker-dealers that are not conducting activities within this country. Consequently, the U.S. investors would have little reason to expect these foreign broker-dealers to be subject to U.S. broker-dealer requirements. Moreover, requiring a foreign broker-dealer to register as a broker-dealer with the Commission because of unsolicited trades with U.S. persons could cause that foreign broker-dealer to refuse to deal with U.S. persons under any circumstances.

As noted in the proposed interpretive statement,[53] however, the Commission generally views "solicitation, in the context of broker-dealer regulation,[54] as including any affirmative effort by a broker or dealer intended to induce transactional business for the broker-dealer or its affiliates.[55] Solicitation

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Attorney, Division of Market Regulation, SEC, to Kevin McMahon, Esq., Jones, Grey & Bayley, P.S. (Aug. 1, 1986) (Barons Mortgage Association); Letter from Lynne G. Masters, Attorney, Office of Chief Counsel, Division of Market Regulation, SEC, to Chester J. Jachimiec, Esq., Winstead, McGuire, Sechrest & Minick (Aug. 3, 1987) (States Petroleum, Inc.). The withdrawal of these no-action positions was discussed when the interpretive statement was proposed, but no comments were received. *See* Release 34–25801, 53 FR at 23650 n.48.

[44] Similarly, only the affiliate's personnel must be licensed appropriately by the NASD or another SRO. *See* sections 3(a)(18) and 15(c)(8) of the Exchange Act, 15 U.S.C. 78c(a)(18) and 78*o*(c)(8).

[45] *See* note 189 *infra* regarding whether registered broker-dealer would be permitted to function as an introducing broker to an unregistered foreign broker-dealer.

[46] The Securities Industry Association ("SIA") and Merrill Lynch & Co., Inc. The SIA inquired concerning contacts originating from outside the United States, while Merrill Lynch addressed contacts originating inside this country also.

[47] Section 15(b)(4)(E) of the Exchange Act, 15 U.S.C. 78*o*(b)(4)(E), imposes reasonable supervision standard, and section 20(a) of the Exchange Act, 15 U.S.C. 78t(a), establishes both controlling person liability and good faith defense.

[48] *See* text accompanying note 27 *supra*.

[49] *See* proposed interpretive statement, Release 34–25801, 53 FR at 23649–51.

[50] The Rule incorporates an exemption for foreign broker-dealers engaging in securities activities with these persons. *See* Part IV.B. *infra*.

[51] *See* Release 34–4708 (a public offering of securities specifically directed toward U.S. citizens abroad, such as military personnel, would be regarded as subject to Securities Act registration); *SEC v. Siamerican Securities, Ltd.*, Litigation Release No. 6937 (June 17, 1975) (charging, among other things, violation of section 15(a) regarding solicitation of securities transactions from American citizens stationed in Southeast Asia, for execution primarily on U.S. exchanges and over-the-counter markets). *See also* Release 33–6779, 53 FR at 22670 n.106 ("offerings specifically targeted at identifiable groups of U.S. citizens resident abroad" would not be eligible for safe-harbor exemption from Securities Act registration under Rule 903 of proposed Regulation S). By "targeting, the Commission means selling efforts intentionally directed toward identifiable groups of U.S. citizens resident abroad.

[52] *See* Release 34–25801, 53 FR at 23646; *see also* Report on Internationalization at V–42.

[53] Release 34–25801, 53 FR at 23650.

[54] Section 15(a)(1) of the Exchange Act requires registration of brokers and dealers that effect securities transactions or "induce *or attempt to induce* the purchase or sale of, any security. 15 U.S.C. 78*o*(a)(1) (emphasis added). If foreign broker-dealer s securities activities brought it within the definitions of "broker or "dealer in section 3(a) (4) or (5), using the U.S. jurisdictional means to solicit trades from U.S. customers would be sufficient to trigger the registration requirements of section 15(a).

[55] The Report on Internationalization said that "[k]ey to the issue of solicitation is whether the

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includes efforts to induce a single transaction or to develop an ongoing securities business relationship. Conduct deemed to be solicitation includes telephone calls from a broker-dealer to a customer encouraging use of the broker-dealer to effect transactions, as well as advertising one s function as a broker or a market maker in newspapers or periodicals of general circulation in the United States or on any radio or television station whose broadcasting is directed into the United States. Similarly, conducting investment seminars for U.S. investors, whether or not the seminars are hosted by a registered U.S. broker-dealer, would constitute solicitation.[56] A broker-dealer also would solicit customers by, among other things, recommending the purchase or sale of particular securities, with the anticipation that the customer will execute the recommended trade through the broker-dealer.

Thirteen commenters argued that this definition of solicitation should be narrowed.[57] In particular, Fidelity Investments did not think that visits to this country by an unregistered foreign broker-dealer "to introduce itself as being available to execute trades" or "to explain regulatory changes occurring in its own jurisdiction" should be deemed solicitation, based on Fidelity's assumption that these activities would not constitute inducements to effect trades through the foreign broker-dealer.[58] The other comments supported broader latitude with respect to the distribution of research by foreign broker-dealers to U.S. institutional investors and with respect to the distribution in this country by foreign exchanges of foreign market makers quotations, both of which the proposed interpretive statement treated as solicitation.[59]

The Commission generally believes that a narrow construction of solicitation would be inconsistent with the express language of section 15(a)(1), which refers to both inducing or attempting to induce the purchase or sale of securities,[60] and would be unwarranted in the context of the domestic application of U.S. broker-dealer registration requirements. As a matter of policy, however, the Commission has created a conditional exemption in the Rule to permit expanded U.S. distribution of foreign broker-dealers' research reports to major U.S. institutions, which is discussed below.

In addition, the Commission believes that expanded third-party distribution of foreign broker-dealers' quotations in this country without registration should be allowed on an interpretive basis.[61] As the proposed interpretive statement explained,[62] the dissemination in the United States of a broker-dealer's quotes for a security typically would be a form of solicitation. The staff nonetheless has given assurances that enforcement action would not be recommended for lack of broker-dealer registration with respect to the collective distribution by organized foreign exchanges of foreign market makers' quotes, in the absence of other inducements to trade on the part of these market makers.[63] Several commenters discussed an exemption in the Rule for the collective distribution of foreign broker-dealers' quotations. The ABA suggested exempting from registration foreign broker-dealers that acted as market makers and provided their names, addresses, telephone numbers, and quotes as part of the collective distribution by a "recognized foreign securities market" of foreign market makers' quotes.[64] Members of the Securities Law Committee of the Chicago Bar Association ("CBA") concurred. Sullivan & Cromwell maintained that the fact-specific nature of these arrangements rendered them more suitable for resolution by the staff through no-action or interpretive procedures. The Public Securities Association ("PSA") suggested that, if a foreign broker-dealer participated in a third-party quotation system "principally directed at foreign persons, dissemination of its quotations to U.S. institutional investors should not be considered solicitation of those investors, provided that the foreign broker-dealer did not engage in other activities in the United States requiring broker-dealer registration.[65]

At the present time, the Commission generally would permit the U.S. distribution of foreign broker-dealers' quotations by third-party systems, *e.g.*, systems operated by foreign marketplaces or by private vendors, that distributed these quotations primarily in foreign countries. The Commission recognizes that access to foreign market makers' quotations is of considerable interest to registered broker-dealers and institutional investors, who seek timely information on foreign market conditions.[66] The Commission's position, however, would apply only to third-party systems that did not allow securities transactions to be executed between the foreign broker-dealer and persons in the United States through the systems. In addition, foreign broker-dealers whose quotes were distributed through the systems would not be allowed to initiate contacts with U.S. persons, beyond those exempted under the Rule, without registration or further exemptive rulemaking. The Commission believes that questions regarding the future development of third-party quotation systems with internal execution capabilities designed, for example, to facilitate cross-border trading in securities while the domestic markets for those securities are closed, should be addressed under present

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foreign broker-dealer's contacts with U.S. markets reasonably may be viewed as attempting to induce an investor's purchase or sale of security. Report on Internationalization at V-42. *See also* Letter from David Romanski, Attorney, Division of Market Regulation, SEC, to Hugh Seymour, Hoare & Govett, Ltd. (Sept. 28, 1973), discussed in Release 34-25801, 53 FR at 23646 n.12 and accompanying text.

[56] *See* Hoare & Govett letter, *supra* note 55.

[57] Fidelity Investments, Madrid Stock Exchange, Dechert Price & Rhoads, Ross & Hardies, CREF Stikeman, Elliott, Continental Bank, Association of German Banks, Toronto Stock Exchange, the SIA, the ABA, the Committee on International Banking, Securities, and Financial Transactions of the International Law and Practice Section of the New York State Bar Association ("NYSBA"), and Sullivan & Cromwell.

[58] Letter from John I. Fitzgerald, Vice President and General Counsel, Fideltiy Investments, to Jonathan G. Katz, Secretary, SEC (Sept. 13, 1988), at 3. Several other commenters agreed. *See* Part IV.B. *infra*.

[59] *See* Release 34-25801, 53 FR at 23650-51.

[60] *See supra* note 54.

[61] *See* Part IV.B. *infra*. The Commission also has created an exemption in the direct contact provisions of the Rule to permit associated persons of foreign broker-dealers to make visits to U.S. institutional investors under limited conditions. The Rule does not permit foreign associated persons to conduct any other activities within this country, unless those activities would not require broker-dealer registration.

[62] Release 34-25801, 53 FR at 23651.

[63] *See* Release 34-25801, 53 FR at 23647 nn.21-27 and accompanying text. The staff's no-action assurances also extended to the execution of trades resulting from these quotes.

[64] Letter from Liftin to Katz, *supra* note 11, at 4. The ABA did not offer any specific criteria for defining "recognized foreign securities market, which it defined as foreign securities market determined by the Commission (or the staff, pursuant to delegated authority) to be entitled to this treatment.

[65] Letter from Frances R. Bermanzohn, Senior Vice President and General Counsel, PSA, to Jonathan G. Katz, Secretary, SEC (Oct. 28, 1988), at 9.

[66] The Commission would have reservations, however, about certain specialized quotation systems, which might constitute a more powerful inducement to effect trades because of the nature of the proposed transactions. For example, foreign broker-dealer whose quotations were displayed in system that disseminated quotes only for large block trades might well be deemed to have engaged in solicitation requiring broker-dealer registration, as opposed to a foreign broker-dealer whose quotes were displayed in a system that disseminated the quotes of numerous foreign dealers or market makers in the same security.

circumstances by the staff on a case-by-case basis or by the Commission in further rulemaking proceedings. The Commission also believes that the *direct* dissemination of a foreign market maker's quotations to U.S. investors, such as through a private quote system controlled by a foreign broker-dealer, would not be appropriate without registration, because the dissemination of these quotations would be a direct, exclusive inducement to trade with that foreign broker-dealer.

4. Registered Broker-Dealers

Some commenters asked the Commission to confirm that foreign broker-dealers would not become subject to the registration requirements of section 15(a) by using the U.S. jurisdictional means to deal only with registered broker-dealers.[67] The staff already has taken no-action positions on broker-dealer registration with respect to foreign broker-dealers engaging in securities transactions with registered broker-dealers and with banks acting in a broker or dealer capacity (including acting as municipal or governmental securites dealers).[68] The Commission has codified this position as an exemption in the Rule,[69] so that transactions by foreign broker-dealers with registered broker-dealers acting as principal or agent, or with banks acting in a broker or dealer capacity, need not take place within the framework established by the proposed rule.[70]

IV Rule 15a-6 and Concept Release

A. Overview

The Commission's response to the issues raised by the comments on the interpretive statement and proposed Rule 15a-6 is threefold. First, the Commission is adopting exemptions allowing *nondirect* contacts between foreign broker-dealers and U.S. investors. Second, the Commission is adopting exemptions allowing *direct* contacts between foreign broker-dealers and certain U.S. investors through intermediaries, and between foreign broker-dealers and certain other persons directly. Third, the Commission is seeking comment in the Concept Release on a conceptual approach based on recognition of foreign regulation as a substitute in part for U.S. broker-dealer registration.

1. Rule 15a-6

The first two prongs of this approach are incorporated in the Rule, which the Commission has decided to adopt in an expanded format substantially as published in Release 34-26136. The Rule thus incorporates much of the proposed interpretive statement to realize the benefits of codification identified by many commenters.[71] As adopted, the Rule contains exemptions from broker-dealer registration for nondirect contacts through unsolicited transactions and the distribution of research reports, and it allows for direct contacts with certain U.S. institutional investors through intermediaries and with certain other defined classes of persons without intermediaries.

2. Recognition of Foreign Securities Regulation

The third prong of the Commission s approach is represented by the Concept Release on recognition of foreign securities regulation also issued today. In the proposed interpretive statement, the Commission noted that the development of comprehensive broker-dealer regulation in foreign nations suggested that agreements with foreign securities authorities as to some form of recognition of foreign broker-dealer regulation might be possible in the future. Under this conceptual approach, a country could recognize regulation of a foreign broker-dealer by the latter's home country as a substitute, to some extent, for its own domestic regulation. The Commission pointed out, however, that this approach "could raise the possibility of reduced U.S. investor protection, unless the foreign jurisdiction had a broker-dealer regulatory system that was comparable and compatible with that of the United States, this system was comprehensively enforced, and ready cooperation in surveillance and enforcement matters between the United States and the foreign jurisdiction was the norm. [72] In light of these factors, the Commission stated that it was weighing whether some degree of mutual recognition of international broker-dealers might be possible in the future.

Seventeen commenters favored some form of mutual recognition.[73] Several of these commenters advocated permitting a foreign broker-dealer to deal directly with U.S. institutional investors after the Commission made a formal determination that its home country s broker-dealer regulatory regime was adequate,[74] particularly if there were a satisfactory information-sharing and mutual cooperation agreement between U.S. and foreign regulators.[75]

The comments indicate great interest by U.S. institutional investors and foreign market professionals and securities authorities in an exemption from broker-dealer registration based on recognition of foreign regulation. The many complex issues inherent in this approach require careful deliberation by the Commission and foreign securities authorities before the parameters of this exemption could be defined sufficiently to realize the desired goals of increased access to foreign markets by U.S. institutional investors, and more efficient regulation of the cross-border activities of foreign broker-dealers, without resulting in reduced protection for U.S. investors and securities markets. Therefore, the Commission has decided to adopt the Rule at the present time, in light of the increasing cross-border activities of foreign broker-dealers and the need for clarification of the application of the U.S. broker-dealer registration requirements to these activities, while also soliciting specific comment on a conceptual approach based on recognition of foreign securities regulation.

3. Withdrawal of Proposed Interpretive Statement

In view of its other actions, the Commission considers it unnecessary to publish separately a final interpretive statement. The Rule as adopted includes exemptions incorporating many of the positions originally set forth in the proposed interpretive statement, and this release specifically discusses

[67] The Institute of International Bankers, the ABA, the PSA, the SIA, Securitiy Pacific Corporation, and Sullivan & Cromwell.

[68] Letter from John Polanin, Jr., Attorney, Office of Chief Counsel, Division of Market Regulation, SEC, to Robert L. Tortoriello, Esq., Cleary, Gottlieb, Steen & Hamilton (July 7, 1988) (National Westminster Bank PLC); Letter from Robert L.D. Colby, Chief Counsel, Division of Market Regulation, SEC, to Robert L. Tortoriello, Esq., Cleary, Gottlieb, Steen & Hamilton (Apr. 1, 1988) (Security Pacific Corporation).

[69] *See* Part IV.B *infra.*

[70] *See* Release 34-25801, 53 FR at 23653-54.

[71] *See supra* notes 11-13 and accompanying text.

[72] Release 34-25801, 53 FR at 23652.

[73] Andras Research Capital Inc., Bank of America, Brown Brothers Harriman, Fidelity Investments, National Companies and Securities Commission (Australia) ("NCSC"), Ross & Hardies, CREF, Stikeman, Elliott, Westpac Banking Corporation, The Toronto Stock Exchange, the Institute of International Bankers, the SIA, James Capel & Co., Debevoise & Plimpton, the Vancouver Stock Exchange, the NYSBA, and The Montreal Exchange.

[74] Westpac Banking Corporation, the Institute of International Bankers, James Capel, and Debevoise & Plimpton.

[75] The SIA advocated that the Commission require participating foreign regulators to accord U.S. broker-dealers "national treatment, *i.e.*, treatment similar to that accorded to domestic broker-dealers in the foreign country.

others, especially in connection with the general principles stated above. To avoid confusion, the Commission is withdrawing the proposed interpretive statement, but the staff's interpretive and no-action letters and the Commission exemptions cited therein will remain valid until expressly modified or withdrawn. In addition, the Commission wishes to confirm that the staff's guidance will continue to remain available regarding both the application of the Rule and the general application of the U.S. broker-dealer registration requirements to the activities of foreign broker-dealers.[76]

B. Rule 15a-6

The Commission is adopting proposed Rule 15a-6 under section 15(a)(2) of the Exchange Act [77] to provide conditional exemptions from broker-dealer registration for foreign broker-dealers that do not initiate direct contacts with U.S. persons, that solicit or effect transactions by certain U.S. institutional investors through registered broker-dealers, or that solicit or effect securities transactions by certain other persons.

1. Structure of the Rule

As previously noted, the Commission is adopting Rule 15a-6 in an expanded format similar to that published in Release 34-26136. A majority of commenters that addressed the issue supported expansion of the proposed exemptive rule to include the substance of the interpretive statement,[78] and the Commission concurs with those comments suggesting that an expanded rule would be understood more easily, especially by foreigners unfamiliar with the Commission interpretive practices. Therefore, Rule 15a-6 as adopted incorporates many of the positions articulated in the interpretive statement, although it differs in some respects from the expanded rule published in Release 34-26136. For ease of reference, the Rule has been organized into nondirect contacts, direct contacts, and trading with or for specified persons.

Rule 15a-6(a) exempts only foreign brokers or dealers, which are defined in paragraph (b)(3) to mean persons not resident in the United States that are not offices or branches of, or natural persons associated with, registered broker-dealers, and whose securities activities would fall within the definitions of "broker" or "dealer" in sections 3(a)(4) or 3(a)(5) of the Exchange Act, respectively.[79] The definition in paragraph (b)(3) expressly includes any U.S. person engaged in business as a broker or dealer entirely outside the United States. This definition also includes foreign banks to the extent that they operate from outside the United States, but not their U.S. branches or agencies.[80]

The proposed rule would have exempted foreign broker-dealers only from section 15(a). The expanded rule also would have exempted foreign broker-dealers required to register as municipal securities dealers by section 15B(a)(1) of the Exchange Act,[81] and several commenters believed that foreign broker-dealers required to register as government securities brokers or dealers by section 15C(a)(1) of the Exchange Act[82] should be included as well.[83] Pursuant to section 15B(a)(4) of the Exchange Act,[84] the Commission has made the exemptions in the Rule applicable to foreign broker-dealers engaging in municipal securities activities involving U.S. investors, although the Commission believes that these activities are not likely to be extensive. In addition, the Commission will recommend to the Department of the Treasury that the latter exercise its authority under section 15C(a)(4) of the Exchange Act [85] to provide similar exemptions to foreign broker-dealers engaging in government securities activities involving U.S. investors.

As proposed, Rule 15a-6(a) was phrased as a conditional exemption from the broker-dealer registration requirements of section 15(a).[86] The expanded rule stated instead that a qualifying broker-dealer "is not subject to" these registration requirements.[87] Several commenters objected that an exemption implied that the exempted activities required registration absent the exemption.[88] The Commission has determined to adopt Rule 15a-6 as an exemption, rather than as an exclusion from registration. In the Commission s view, many of the activities covered by provisions of the Rule plainly would require registration, absent an exemption. To keep the rule as simple as possible, the Commission is adopting all the provisions of the Rule as exemptions from registration, pursuant to sections 15(a)(2) and 15B(a)(4) of the Exchange Act.[89]

Several commenters argued that failure to comply with the proposed rule in one instance should not affect the availability of the exemptions under the proposed rule in other cases.[90] The justifications proffered by these commenters were the desire to avoid attaching "unduly severe consequences to "isolated, inadvertent violations" [91]

[76] Questions on this subject should be addressed to the Office of Chief Counsel, Division of Market Regulation, Securities and Exchange Commission, 450 Fifth St. NW., Mail Stop 5-1, Washington, DC 20549, (202) 272-2848.

[77] 15 U.S.C. 78o(a)(2).

[78] Of the thirteen commenters who addressed the question of whether the substance of the interpretive statement should be included in the proposed rule, eleven supported expansion of the rule: Continental Illinois National Bank and Trust Company of Chicago, the PSA, The Toronto Stock Exchange, the Institute of International Bankers, Chase Manhattan Government Securities, the SIA, Security Pacific Corporation, Salomon Brothers Inc., Sullivan & Cromwell, Merrill Lynch, and the CBA. The NYSBA, while not commenting explicitly on expansion of the proposed rule, suggested that in terpretive statement be "converted into an interpretive rule" to provide foreign broker-dealers "a clearer basis" on which to evaluate the application of U.S. law to their activities. Letter from Lauren D. Rachlin, Chairman, NYSBA, to Jonathan G. Katz, Secretary, SEC (Nov. 7, 1988), at 5. The Institute of International Bankers suggested that the Commission retain the proposed interpretive statement for discussion of matters not specifically addressed by the ABA's formulation of the proposed rule. The SIA, Security Pacific, Salomon Brothers, and Merrill Lynch believed that the Commission should make clear that future requests for interpretive guidance still would be considered after the adoption of the Rule. Only the PSA (which preferred the ABA' approach if the Commission adopted the Rule) and The Montreal Exchange argued against an expanded rule, believing that codification of interpretive positions on foreign broker-dealer registration would impair the staff's ability to exercise its judgment on this subject in flexible manner.

[79] *Supra* notes 16-17. *See also* note 19 *supra* regarding Rule 3a4-1, 17 CFR 240.3a4-1.

[80] The Institute of International Bankers contended that U.S.-regulated branches or agencies of foreign banks should be excluded from broker-dealer registration in the same way as domestic banks, by virtue of section 3(a)(6) of the Exchange Act, 15 U.S.C. 78c(a)(6). As explained in note 16 *supra*, the Commission has taken the position that the status of these branches and agencies under section 3(a)(6) is fact-specific, and U.S. branches or agencies of foreign banks that fall within the definition of bank under section 3(a)(2) of the Securities Act will be treated as U.S. institutional investors under the Rule. *See also* note 168 *infra*.

[81] 15 U.S.C. 78o-4(a)(1).

[82] 15 U.S.C. 78o-5(a)(1).

[83] The ABA, the PSA, and the CBA.

[84] 15 U.S.C. 78o-4(a)(4).

[85] 15 U.S.C. 78o-5(a)(4).

[86] *See supra* note 10.

[87] Release 34-26136, 53 FR at 38968.

[88] The ABA, Sullivan & Cromwell, the PSA, and Continental Bank.

[89] *See* notes 77 and 84 *supra*. Section (a) of the proposed rule also stated that the rule applied to any foreign broker-dealer "subject to the registration requirements of paragraph (1) of section 15(a) of the Act, because it induces or attempts to induce the purchase or sale of any security by U.S. person. Release 34-25801, 53 FR at 23655. This language has been deleted from the Rule, because it merely restated the language of section 15(a)(1), 15 U.S.C. 78o(a)(1). The exemption under Rule 15a-6 is necessary only if the registration requirements of section 15(a) are triggered. As stated in Part IV.A. above, the staff guidance will continue to be available on this issue.

[90] The PSA, Security Pacific Corporation, and Sullivan & Cromwell.

[91] Letter from Dan C. Aardal, Assistant General Counsel, Security Pacific Corporation, to Jonathan G. Katz, Secretary, SEC (Oct. 31, 1988).

and the belief that enforcement considerations did not prohibit a transactional approach, since remedies are available to both the Commission and private investors on a transactional basis.[92]

In the Commission's view, failure to comply with the conditions of one exemption in the Rule regarding certain activities would not prevent reliance on the same or other exemptions in the Rule with respect to other activities. Also the Commission is modifying the position expressed in the proposed interpretive statement that a foreign broker-dealer's obligation to register, once incurred, "continues until the foreign broker-dealer completely ceases to do business with or for [U.S.] investors" whom it has solicited and with or for whom it has effected securities transactions.[93] With respect to the Commission's exercise of its enforcement authority under section 15(a), the Commission would view a violation of U.S. registration requirements by a foreign broker-dealer as an ongoing violation until the foreign broker-dealer completely ceased to conduct U.S. securities activities that were not exempt under the Rule, or that required registration under the general principles discussed earlier in this release. Of course, the foreign broker-dealer would remain liable for its violative conduct, even after it ceased all nonexempt U.S. securities activities. Further, if a foreign broker-dealer repeatedly engaged in nonexempt U.S. securities activities intermittently with exempt U.S. activities, this course of conduct could support the conclusion that the foreign broker-dealer was in violation of section 15(a) during the entire course of its U.S. activities.[94]

[92] The commenters did not elaborate or mention explicitly section 29(b) of the Exchange Act, 15 U.S.C. 78cc(b). *See* note 94 *infra*.

[93] Release 34-25801, 53 FR at 23651.

[94] If foreign broker-dealer deals with U.S. investors in violation of the broker-dealer registration requirements, it would be subject to Commission enforcement action under section 15(a) of the Exchange Act, *supra* note 10. Indeed, one commenter, even while recommending changes to proposed Rule 15a-16, exhorted the Commission, "after spending extensive efforts in developing concise codification of interpretative and exemptive positions which will inure to the benefit of all broker-dealers, domestic and foreign, [to] be prepared to demand appropriate compliance with the registration requirements of the 1934 Act with respect to entities engaging in activity which requires registration and which is outside of the exemptions provided by proposed Rule 15a-16. Letter from Donald N. Gershuny, Merrill Lynch & Co., Inc., to Jonathan G. Katz, Secretary, SEC (Oct. 31, 1988).

The foreign broker-dealer also still would be subject to the Commission's broker-dealer rules, because the definition of "registered broker or dealer" in section 3(a)(48) of the Exchange Act, 15 U.S.C. 78c(a)(48), includes a broker-dealer "required to register" pursuant to section 15(a). Also included are brokers and dealers registered or required to register pursuant to section 15B, 15 U.S.C. 78o-4, and, with respect to the definition of "member" in section 3(a)(3), 15 U.S.C. 78c(a)(3), and sections 6 and 15A regarding national securities exchanges and registered securities associations, respectively, 15 U.S.C. 78f and 78o-3, those entities and government securities brokers and government securities dealers registered or required to register pursuant to section 15C(a)(1)(A), 15 U.S.C. 78o-5(a)(1)(A).

It should be noted also that a foreign broker-dealer dealing with U.S. investors in violation of the broker-dealer registration requirements potentially would be exposed to customers' rescission actions brought under section 29(b) of the Exchange Act, 15 U.S.C. 78cc(b). *See, e.g., Regional Properties, Inc. v. Financial & Real Estate Consulting Co.*, 678 F.2d 552, 558 (5th Cir. 1982), *aff'd on other grounds*, 752 F.2d 178 (5th Cir. 1985) (later appeal); *Eastside Church of Christ v. National Plan, Inc.*, 391 F.2d 357 (5th Cir.), *cert. denied*, 393 U.S. 913 (1968) (allowing investors to rescind transactions with unregistered broker-dealer). *See also* Gruenbaum & Steinberg, *Section 29(b) of the Securities Exchange Act of 1934: A Viable Remedy Awakened*, 48 Geo. Wash. L. Rev. 1 (1979). The right of rescission under section 29(b), 15 U.S.C. 78cc(b), ordinarily would be invoked by private parties, and the Commission believes that it would not be appropriate to make general statement on the availability of that right in the context of adopting the Rule.

Of course, the broker-dealer's securities activities would continue to be subject to the antifraud provisions of the federal securities laws, *e.g.*, section 17(a) of the Securities Act, 15 U.S.C. 77q(a), and sections 10(b) and 15(c) of the Exchange Act, 15 U.S.C. 78j(b) and 78o(c), and the rules thereunder, *e.g.*, Rules 10b-5 and 15c1-2, 17 CFR 240.10b-5 and 240.15c1-2, irrespective of the firm's lack of registration. The extraterritorial application of the antifraud provisions of the federal securities laws was discussed in the proposed interpretive statement. Release 34-25801, 53 FR at 23649 n.39. *See also* note 41 *supra*. The Commission continues to believe that the antifraud provisions should be interpreted broadly to restrain securities fraud affecting the United States. *See Consolidated Gold Fields PLC v. Minorco, S.A.*, 871 F.2d 252 (2d Cir. 1989).

2. Nondirect Contacts

a. *Unsolicited Transactions.* As discussed previously, the Commission believes that registration should not be required when a foreign broker-dealer effects an unsolicited trade for a U.S. investor. Accordingly, paragraph (a)(1) of the Rule exempts from registration a foreign broker-dealer to the extent that it "effects transactions in securities with or for persons that have not been solicited by the foreign broker or dealer. This paragraph codifies part of the proposed interpretive statement[95] and generally has been taken from paragraph (a)(2) of the expanded rule published in Release 34-26136.[96]

[95] *See* Release 34-25801, 53 FR at 23650-51.

[96] The adopted language differs from the expanded rule in two ways. The expanded rule referred to "execution" of transactions, but "effects" is consistent with the express language of section 15(a)(1) of the Exchange Act, 15 U.S.C. 78o(a)(1). Also, the expanded rule referred to solicitation of "customers" without defining them, but "persons" is preferable because of its definition in section 3(a)(9) of the Exchange Act. *See* note 40 *supra*.

The expanded rule did not define the concept of solicitation, and neither does the Rule as adopted. The Commission's general views on meaning of the term "solicitation" have been discussed previously. Taking into account the expansive, fact-specific, and variable nature of this concept, the Commission believes that the question of solicitation is best addressed by the staff on a case-by-case basis, consistent with the principles elucidated in this release.

b. *Provision of Research to U.S. Persons.* As noted in the interpretive statement,[97] the provision of research to investors also may constitute solicitation by a broker or dealer. Broker-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.

Consistent with earlier staff no-action positions,[98] however, the proposed interpretive statement took the position that the provision to U.S. persons of research reports prepared by a foreign broker-dealer would not require broker-dealer registration by that foreign broker-dealer, if the research reports were distributed to U.S. persons by an affiliated U.S. broker-dealer, if that affiliated broker-dealer prominently stated on the research report that it had accepted responsibility for its content, if the research report prominently indicated that any U.S. persons receiving the research and wishing to effect transactions in any security discussed therein should do so with the U.S. affiliate, not the foreign broker-dealer, and if transactions with U.S. persons in any securities identified in the research actually were effected only with or through the U.S. affiliate, not the

[97] Release No. 25810, 53 FR at 23650-51.

[98] *See* Release 34-25801, 53 FR at 23646-48.

foreign broker-dealer.[99] This position was incorporated into paragraph (a)(3) of the expanded rule in Release 34-26136, although the requirement for affiliation between the registered broker-dealer and the foreign broker-dealer was deleted.

Some commenters criticized this position on research as too restrictive.[100] For example, Fidelity Investments claimed that, while the research that it receives from foreign broker-dealers is "voluminous, it plays "only a very small part" in the final investment decisions made by its fund managers.[101] The Madrid Stock Exchange argued that research distributed free of charge in the United States by foreign broker-dealers to U.S. institutional investors "on a routine basis, for information purposes" should not be deemed solicitation of brokerage business.[102] CREF agreed that any other position would impede the flow of foreign research to U.S. institutional investors.

Dechert Price & Rhoads, on behalf of five Spanish broker-dealers, argued that provision of research to existing U.S. institutional clients should not be deemed solicitation, even if trades were effected for those clients as a result.[103] These foreign broker-dealers believed that it would be difficult for them to screen out transactions from U.S. institutional investors that have received their research. They maintained that it would be too costly for smaller foreign broker-dealers to establish U.S. affiliates to be responsible for and distribute their research and effect any resulting trades, and that larger foreign broker-dealers thus would have a competitive advantage. The Association of German Banks also objected to the requirement that the U.S. affiliate prominently state that it had accepted responsibility for a research report prepared by a foreign broker-dealer. The SIA, while not objecting to the proposed interpretive position on research itself, suggested that foreign broker-dealers should be allowed to send research directly to U.S. institutional investors, as long as U.S. affiliates accepted responsibility for the research and effected any resulting trades.[104]

In publishing the proposed rule and interpretive statement, the Commission was motivated, in part, by the desire of U.S. institutional investors for access to foreign markets through foreign broker-dealers and the research that they provide.[105] Accordingly, the Rule takes into account the comments on the important role of research in facilitating access to these markets. The Commission does not wish to restrict major U.S. investors' ability to obtain research reports of foreign origin if adequate regulatory safeguards are present.

Paragraph (a)(2) of the Rule therefore provides an exemption from registration for foreign broker-dealers that furnish research reports[106] directly or indirectly[107] to major U.S. institutional investors[108] under certain conditions. The research report must not recommend the use of the foreign broker-dealer to effect trades in any security,[109] and the foreign broker-dealer must not initiate follow-up contact with the major U.S. institutional investors receiving the research, or otherwise induce or attempt to induce the purchase or sale of any security by those major U.S. institutional investors.[110] If these conditions are met, the foreign broker-dealer may effect trades in the securities discussed in the research or other securities at the request of major U.S. institutional investors receiving the report. Under these conditions, the Commission believes that direct distribution would be consistent with the free flow of information across national boundaries without raising substantial investor protection concerns.

If, however, the foreign broker-dealer already had a relationship with a registered broker-dealer that facilitated compliance with the direct contact exemption in the Rule, the Rule would require all trades resulting from the provision of research to be effected through that registered broker-dealer pursuant to the provisions of that exemption. If the foreign broker-dealer had entered into this prior relationship, the procedures for identifying trades from major U.S. institutional investors and routing them through the registered broker-dealer largely would have been established. Thus, the benefits of a registered broker-dealer's intermediation in effecting trades would

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[99] Article III, section 35(d)(2) of the NASD Rules of Fair Practice requires that all "[a]dvertisements and sales literature shall contain the name of the [NASD] member, [and of] the person or firm preparing the material, if other than the member" and that "[s]tatistical tables, charts, graphs or other illustrations used by members should disclose the source of the information if not prepared by the member. *NASD Manual* (CCH) ¶ 2195 at 2177-78. Under section 35(a)(1), "advertisement" means any "material published, or designed for use in" various public print and electronic media. *Id.* at 2174. Under section 35(a)(2), "sales literature" specifically includes "research reports, market letters, performance reports or summaries, [and] seminar texts. *" *Id.* Rule 472.40(7) of the New York Stock Exchange ("NYSE") requires that communications with the public that are "not prepared under the direct supervision of the [NYSE] member organization or its correspondent [NYSE] member organization should show the person (by name and appropriate title) or outside organization which prepared the material. *NYSE Guide* (CCH) ¶ 2472.40(7) at 4027. Under Rule 472.10(1), a "communication" includes "market letters [and] research reports *Id.* at ¶ 2472.10(1). The Commission would not view an activity that merely complied with these requirements, in itself, as solicitation by a foreign broker-dealer.

[100] *See* note 13 *supra.*

[101] Letter from Fitzgerald to Katz, *supra* note 58, at 3.

[102] Letter from Enrique Benito Rodriquez, Chairman, Madrid Stock Exchange, to Jonathan G. Katz, Secretary, SEC (Oct. 21, 1988), at 2.

[103] CREF also said that communications between a foreign broker-dealer and a U.S. investor after the investor had opened its account with the foreign broker-dealer on the investor's own initiative should not be deemed solicitation. The Toronto and Vancouver Stock Exchanges agreed. The Commission believes, however, that the existence of these communications could support the conclusion that the foreign broker-dealer was engaged in the securities business within the jurisdiction of the United States, by virtue of having regular customers, and thus was subject to U.S. broker-dealer registration requirements.

[104] While expressing general agreement with the discussion of research in the proposed interpretive statement, Sullivan & Cromwell concurred with the SIA on this point, as did the NYSBA and the ABA, although the ABA did not suggest imposition of the execution condition explicitly.

[105] Release 34-25801, 53 FR at 23648.

[106] Paragraph (a)(2) of the Rule would not distinguish between research reports provided in written or electronic form.

[107] As adopted, paragraph (a)(2) is broader than the proposed interpretive statement in that, like the expanded rule, it permits the distribution of foreign research in this country directly by foreign broker-dealer.

[108] Paragraph (b)(4) of the Rule defines "major U.S. institutional investor" as a U.S. institutional investor with assets, or assets under management, in excess of $100 million, or a registered investment adviser with assets under management in excess of $100 million. Paragraph (b)(7) of the Rule defines "U.S. institutional investor" as 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, 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). To determine the total assets of an investment company under the Rule, registered investment company may include the assets of any family of investment companies of which it is a part, and the term "family of investment companies" is defined in paragraph (b)(1) of the Rule.

[109] The Commission would not consider disclosure in the research report that the foreign broker-dealer is a market maker in a security discussed in the report to violate this requirement.

[110] If 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.

be provided without imposing substantial additional costs.

Although this exemption is limited to major U.S. institutional investors, the Rule's research exemption is broader than either the proposed interpretive statement or the expanded rule in that a registered broker-dealer would not be required to take responsibility for the content of the report.[111] In addressing the responsibilities of the U.S. affiliate under paragraph (a) of the proposed rule, some commenters maintained that the registered broker-dealer's performance of supervisory responsibilities would result in little additional protection, at least with respect to substantial institutional investors.[112]

By its terms, the exemption in paragraph (a)(2) of the Rule is available only with respect to research provided to major U.S. institutional investors. Therefore, the Commission has decided to retain the narrower position regarding the distribution of research expressed in Release 34-25801 with respect to other investors.[113] Under this position, the Commission would not require broker-dealer registration by a foreign broker-dealer whose research reports were distributed [114] to U.S. persons by a registered broker-dealer,[115] if that broker-dealer prominently stated on the research report that it had accepted responsibility for its content,[116] if the research report prominently indicated that any U.S. persons receiving the research and wishing to effect any transactions in any security discussed in the report should do so with the registered broker-dealer, not the foreign broker-dealer, and if transactions with U.S. recipients of the report in any securities identified in the research actually were effected only with or through the registered broker-dealer, not the foreign broker-dealer. This position is consistent with the Commission's goal of facilitating the flow of information and capital across national boundaries.[117]

The Commission wishes to emphasize, however, that neither the exemption nor this position regarding research is applicable with respect to "soft-dollar" arrangements between foreign broker-dealers and U.S. persons.[118] As discussed in the proposed interpretive statement,[119] in many cases research is provided to customers with the express or implied understanding that the customers will pay for it by directing trades to the broker-dealer that result in an agreed-upon level of commission dollars.[120] These "soft-dollar" research arrangements are used widely by broker-dealers both in the United States and abroad.[121] If a foreign broker-dealer provided research to a U.S. investor pursuant to an express or implied understanding that the investor would direct a given amount of commission income to the foreign broker-dealer, the Commission would consider the foreign broker-dealer 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. Accordingly, both the exemption for research in paragraph (a)(2) and the position retained from Release 34-25801 set forth above would be inapplicable.[122]

c. Investment Adviser Registration. Finally, it is important to emphasize that foreign broker-dealers must consider separately other registration requirements contained in the U.S. securities laws. Specifically, in the proposed interpretive statement, the Commission noted that if a branch or affiliate of a foreign entity in the United States disseminated research information, registration as an investment adviser might be required under section 203 of the Investment Advisers Act of 1940 ("Advisers Act").[123] Several commenters requested clarification on this point, one expressing concern that a previous no-action position taken by the Division of Investment Management [124] might not apply in light of the direct communications between foreign broker-dealers and certain U.S. institutional investors that could take place under the proposed rule if adopted. A foreign broker-dealer providing research to U.S. persons generally would be an investment adviser within the meaning of the Advisers Act. The staff takes the position that the broker-dealer exclusion in section 202(a)(11)(C) of the Advisers Acts [125]—for broker-dealers who provide investment advice that is solely incidental to their brokerage business and who receive no special compensation for such advice—is available only to registered broker-dealers.

The Division of Investment Management, however, generally would expect to respond favorably to no-action requests regarding registration under the Advisers Act by foreign brokers and dealers who meet the conditions of paragraph (a)(2), (a)(3), or (a)(4) of the Rule if their activities are limited to those described in section 202(a)(11)(C) [126]—that is, if they provide investment advice solely incidental to their brokerage business and receive no special compensation for it. In the future, the Commission may consider whether to propose and adopt an exemptive rule under the Advisers Act for foreign broker-dealers providing the types of services covered by the Rule.

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[111] Of course, if a foreign broker-dealer, for its own business reasons, chose to distribute its research in the United States through registered broker-dealer, affiliated or not, the SRO rules discussed in note 99 *supra* would require disclosure of the identity of the preparer of the research.

[112] *E.g.*, Association of German Banks.

[113] *See supra* notes 98-99 and accompanying text.

[114] The Commission would not require registration by a foreign broker-dealer whose research reports were included in broadly-distributed electronic database to which U.S. persons who were not major U.S. institutional investors had access, provided that (i) registered broker-dealer accepted responsibility for the research and for its inclusion in the database, (ii) the registered broker-dealer prominently stated on the research report (as displayed in the database) that it had accepted responsibility for its content, and (iii) the research report prominently indicated that any U.S. persons accessing the report and wishing to effect any transactions in the securities discussed in the report should do so with the registered broker-dealer, not the foreign broker-dealer. This position would not limit the research exemption in paragraph (a)(2) of the Rule for research distributed directly to major U.S. institutional investors, whether in written or electronic form.

[115] The requirement for affiliation between the foreign broker-dealer and the registered broker-dealer through ownership or control has been deleted here as in the Rule.

[116] As noted above, commenters expressed concern over the ability of the registered broker-dealer to accept responsibility for research prepared by the foreign broker-dealer. The Commission believes that a registered broker-dealer would meet its responsibility under the Rule if it took reasonable steps to satisfy itself regarding the key statements in the research. In cases where there are no indications that the content of the research is suspect, this responsibility can be fulfilled by reviewing the research in question and comparing it with other public information readily available regarding the issuer, to make certain that neither the facts nor the analysis appear inconsistent with outstanding information regarding the issuer.

[117] *See supra* note 1.

[118] Paragraph (a)(2)(iv) of the exemption so provides.

[119] Release 34-25801, 53 FR at 23651.

[120] *See* Release 34-25801, 53 FR at 23646 n.16 and accompanying text.

[121] For example, the Securities and Investments Board ("SIB") notes in recent discussion paper that soft-dollar arrangements in the United Kingdom have increased significantly at time when the level of brokerage commissions generally has decreased. SIB, *Soft Commission Arrangements in the Securities Markets* (February 1989).

[122] CREF explicitly stated that its position against deeming research to be solicitation did not apply to "soft-dollar" arrangements.

[123] 15 U.S.C. 80b-3. *See* Release 34-25801, 53 FR at 23651 n.56.

[124] *Citicorp* (pub. avail. Sept. 14, 1986).

[125] 15 U.S.C. 80b-2(a)(11)(C).

[126] *Id.*

3. Direct Contacts

a. Transactions with U.S. Institutional Investors and Major U.S. Institutional Investors. Paragraph (a)(3) of the Rule provides an exemption from broker-dealer registration for a foreign broker-dealer that induces or attempts to induce the purchase or sale of any security by a U.S. institutional investor or a major U.S. institutional investor,[127] provided that any resulting transactions are effected through a registered broker-dealer and certain conditions are met by the foreign broker-dealer, foreign associated persons, and the registered broker-dealer. As described in the proposed interpretive statement,[128] many foreign broker dealers have established registered broker-dealer affiliates in the United States that are fully qualified to deal with U.S. investors and trade in U.S. securities. Nonetheless, these foreign broker-dealers may prefer to deal with institutional investors in the United States from their overseas trading desks, where their dealer operations are based. In addition, because overseas trading desks often are principal sources of current information on foreign market conditions and foreign securities, many U.S. institutions want direct contact with overseas traders. Foreign broker-dealers themselves often are not willing to register as broker-dealers directly with the Commission, however, because registration would require the entire firm to comply with U.S. broker-dealer requirements.[129]

The no-action request granted to Chase Capital Markets US [130] allowed foreign trading operations to receive calls from U.S. institutional investors without the foreign broker-dealers registering with the Commission. Under the terms of that letter, foreign broker-dealers could be put in touch with U.S. institutional investors by a registered broker-dealer affiliate, with a U.S. qualified representative participating in telephone conversations, effecting any resulting transactions, and taking full responsibility for the trades. Like an earlier Commission exemption letter,[131] the letter to Chase Capital Markets US provided that the foreign broker-dealer would assist the Commission in the conduct of investigations by furnishing information concerning its contacts with U.S. investors and trading records relating to the execution of U.S. investors' orders by the firm. Both letters also indicated that the foreign broker-dealers would endeavor, directly or indirectly, to obtain the consent of foreign customers to the release of any information sought by the Commission.

In the Commission's view, it is desirable to broaden U.S. investors' access to foreign sources of information through structures that maintain fundamental investor protections. Accordingly, the Commission supports allowing direct contact between foreign broker-dealers and U.S. institutional investors, subject to requirements concerning these contacts and the execution of orders.[132] The Rule as adopted allows a foreign broker-dealer to contact U.S. institutional investors if an associated person of a registered broker-dealer participates in each of these contacts. The Rule also allows a foreign broker-dealer to contact major U.S. institutional investors without the participation of an associated person of a registered broker-dealer in any of these contacts. In each case, any resulting transactions must be effected through an intermediary registered broker-dealer,[133] which need not be affiliated with the foreign broker-dealer through ownership or control. The Commission believes that these versions of the intermediary concept used in the Chase Capital Markets US letter and set forth in the proposed rule and the expanded rule greatly increase the utility of the exemption in paragraph (a)(3) of the Rule, the operation of which is described more fully below.[134]

(1) Comments on U.S. broker-dealer requirement. As proposed, Rule 15a-6 would have provided an exemption from broker-dealer registration for foreign broker-dealers that effected trades with certain U.S. institutional investors through a registered broker-dealer.[135] The foreign broker-dealer's personnel involved in contacts with U.S. institutional investors would have been subject to certain requirements, and the registered broker-dealer would have been responsible for supervising the contact and any resulting trades. If a trade was agreed upon, the rule would have required the registered broker-dealer to effect the trade on behalf of the investor, taking full responsibility for all aspects of the trade. In proposing Rule 15a-6, the Commission stated that requiring the intermediation of a registered broker-dealer would maintain important regulatory safeguards. The registered broker-dealer's responsibility for effecting all trades, combined with its recordkeeping and reporting duties pursuant to section 17 of the Exchange Act [136] and the rules thereunder,[137] "would facilitate Commission review of this trading and also subject this trading to the U.S. broker-dealer's supervisory responsibility. [138]

Fifteen commenters argued that the Commission should not require the participation of a registered broker-dealer affiliate in transactions with major institutional investors.[139] In particular, commenters asserted that U.S. institutions meeting the $100 million asset test in the proposed rule should be able to be solicited by foreign broker-dealers and then transact business directly with those broker-dealers, because requiring the intermediation of a registered broker-dealer would increase costs, impede the flow of foreign research to U.S. institutions, and reduce the ability of these institutions to invest in foreign markets in which local broker-dealers had not established registered U.S. affiliates.[140] Other commenters maintained that the Commission should grant an exemption from the registration requirements of section 15(a) to foreign broker-dealers

[127] *See infra* notes 156-69 and accompanying text; *see also* note 108 *supra.*

[128] Release 34-25801, 53 FR at 23651.

[129] *See supra* notes 44-45 and accompanying text.

[130] Letter from Amy Natterson Kroll, Attorney, Office of Chief Counsel, Division of Market Regulation, SEC, to Frank C. Puleo, Esq., Milbank, Tweed, Hadley & McCloy (July 28, 1987).

[131] *See* Letter from Jonathan Katz, Secretary, SEC, to Marcia MacHarg, Esq., Debevoise & Plimpton (Aug. 13, 1986) (Vickers da Costa Securities Inc./Citicorp), *infra* note 205 and accompanying text.

[132] *See* Release 34-25801, 53 FR at 23652.

[133] It would be permissible for more than one registered broker-dealer to serve as intermediary between U.S. institutional investors, major U.S. institutional investors, and a foreign broker-dealer seeking to comply with the Rule.

[134] The Division of Investment Management generally would expect to respond favorably to no-action requests regarding registration as an investment adviser from foreign broker-dealers complying with the provisions of paragraph (a)(3) of the Rule. *See supra* notes 123-26 and accompanying text.

[135] Release 34-25801 did not make clear, however, whether the registered broker-dealer was required to be affiliated with the foreign broker-dealer. *See* note 142 *infra.*

[136] 15 U.S.C. 78q.

[137] *See* note 28 *supra.*

[138] Release 34-25801, 53 FR at 23654.

[139] Andras Research Capital, Brown Brothers Harriman, Fidelity Investments, Madrid Stock Exchange, Ross & Hardies, CREF Dechert Price & Rhoads, Association of German Banks, Westpac Banking Corporation, Toronto Stock Exchange, Institute of International Bankers, Chase Manhattan Government Securities, the ABA, The Canadian Bankers' Association, and The Montreal Exchange.

[140] For example, the Toronto Stock Exchange believed that the costs of establishing registered U.S. broker-dealer affiliate would be significant. In addition, the PSA and Chase Manhattan Government Securities argued that requiring the participation of a U.S. affiliate would be excessively burdensome where the only contact with U.S. investors related to transactions in U.S. government securities.

that deal only with institutional investors, on the grounds that these investors can fend for themselves in the international securities markets.[141] As discussed below in Part IV.B., however, the Commission believes that not all the regulatory concerns raised by such an exemption would be alleviated by the institutional nature or size of these investors.

The Commission had requested comment on whether the nature of the relationship between the foreign broker-dealer and the registered broker-dealer "should involve a specified degree of ownership or control." [142] Three commenters replied that no affiliate relationship should be required between the foreign broker-dealer and the intermediary registered broker-dealer.[143] These commenters generally argued that the use of any registered broker-dealer to perform the duties set forth in the proposed rule would provide sufficient investor protection and would lower the costs of compliance with the rule by smaller foreign broker-dealers. Finally, one commenter suggested that nonresident registered broker-dealers be permitted to perform the duties assigned to the registered broker-dealer by the proposed rule, regardless of their location or affiliation with the foreign broker-dealer.[144]

Nine commenters argued that the responsibilities imposed on the registered broker-dealer affiliate by the proposed rule should be reduced in some fashion.[145] The comments stated that the registered broker-dealer's supervisory responsibilities regarding the activities of the foreign broker-dealer should be relaxed, because the registered broker-dealer's lack of information and control regarding the foreign broker-dealer's activities and relative lack of expertise in foreign securities and markets would hinder the performance of its supervisory duties. In particular, one commenter said that the foreign broker-dealer alone should be responsible for all requirements concerning confirmation and extension of credit in connection with securities transactions, "and correspondingly liable in case of failure." [146] Another commenter emphasized the protection afforded by other provisions in the proposed rule and the registered broker-dealer's difficulty in supervising foreign personnel operating independently in different time zones.[147]

Other commenters took a slightly different approach, suggesting that the registered broker-dealer be allowed to delegate certain functions, but not liability for performing them, to the foreign broker-dealer. Thus, these commenters would allow the registered broker-dealer to assume liability for the acts and omissions of the foreign broker-dealer, rather than actually performing the functions assigned to the registered broker-dealer by the proposed rule. They also opposed requiring the registered broker-dealer to maintain all books and records for U.S. institutional investors' accounts, claiming that the requirement in the rule for the foreign broker-dealer to provide the Commission, upon request, with information or documents within its possession, custody, or control would be an adequate substitute.

The Commission has determined to continue to require the intermediation of a registered broker-dealer,[148] to address concerns regarding financial responsibility and the effective enforcement of U.S. securities laws. The Rule does not require, however, any affiliation between the foreign broker-dealer and the registered broker-dealer through ownership or control. This position, together with the conditional eligibility of nonresident registered broker-dealers to serve as intermediary under the Rule,[149] should reduce greatly the costs incurred by a foreign broker-dealer in establishing a relationship with a registered broker-dealer to comply with the conditions of the direct contact exemption. Accordingly, the Commission does not believe that it is appropriate to allow the registered broker-dealer to delegate the performance of its duties under the Rule to the foreign broker-dealer, with the exception of physically executing foreign securities trades in foreign markets or on foreign exchanges,[150] and merely retain responsibility for errors or omissions in their performance. With respect to the recordkeeping requirements in the Rule, however, the Commission notes that it might be more efficient and less costly for the registered broker-dealer to handle data processing in a centralized fashion. As long as the registered broker-dealer has physical possession of all records required by the Rule, employing a third party, such as the foreign broker-dealer, to process these records mechanically would be permissible.

The Commission believes that the concerns expressed by commenters over the proposed rule's imposition on the registered broker-dealer of supervisory responsibility concerning transactions under paragraph (a)(3) between the foreign broker-dealer and U.S. institutional investors or major U.S. institutional investors are, to some extent, valid. Accordingly, the Commission would no longer take the position that the Rule requires the registered broker-dealer to implement procedures to obtain positive assurance that the foreign broker-dealer is operating in accordance with U.S. requirements.[151] The Commission believes, however, that the registered broker-dealer, in effecting trades arranged by the foreign broker-dealer, has a responsibility to review these trades for indications of possible violations of the federal securities laws. The registered broker-dealer's intermediation in these trades is intended to help protect U.S. investors and securities markets. The registered broker-dealer would have an obligation, as it has for all customer accounts, to review any Rule 15a-6 account for indications of potential problems.[152]

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[141] *E.g.*, the SIA.

[142] Release 34-25801, 53 FR at 23653 n.68.

[143] Institute of International Bankers, Sullivan & Cromwell, and Dwight D. Quayle, Esq., of Ropes & Gray.

[144] Quayle.

[145] Fidelity Investments, the NCSC, the PSA, Westpac Banking Corporation, the SIA, Debevoise & Plimpton, Security Pacific, Sullivan & Cromwell, and Merrill Lynch.

[146] Letter from Dennis H. Greenwald, Chairman, Federal Regulation Committee, SIA, to Jonathan G. Katz, Secretary, SEC (Oct. 31, 1988), at 11.

[147] Security Pacific.

[148] The Rule draws on the definition of "U.S. broker or dealer" in the expanded rule. Paragraph (b)(5) of the Rule defines the term "registered broker or dealer" to include persons registered with the Commission under sections 15(b), 15B(a)(2), or 15C(a)(2) of the Exchange Act, 15 U.S.C. 78*o*(b), 78*o*-4(a)(2), or 78*o*-5(a)(2), respectively.

[149] The Rule permits a nonresident registered broker-dealer to serve as intermediary under the Rule, provided that the nonresident broker-dealer complies with Rule 17a-7(a), 17 CFR 240.17a-7(a). *See* Part IV.B. *infra*.

[150] *See infra* note 185 and accompanying text.

[151] Release 34-25801, 53 FR at 23654.

[152] In particular, SRO rules impose specific supervisory duties on SRO members regarding customers accounts. *E.g.*, Article III, Section 27 NASD Rules of Fair Practice, *NASD Manual* (CCH) ¶2177 at 2109 ("Each member shall review the activities of each office, which shall include the periodic examination of customer accounts to detect and prevent irregularities or abuses. * * *"); NYSE Rule 342.18, *NYSE Guide* (CCH) ¶2342 at 3587 ("Duties of supervisors of registered representatives should ordinarily include at least review of correspondence of registered representatives, transactions, and customer accounts."); NYSE Rule 405, *NYSE Guide* (CCH) ¶2405 at 3696 ("Every member organization is required to (1) Use due diligence to learn the essential facts relative to every customer, every order, [and] every cash or margin account accepted or carried by such organization. (2) Supervise diligently all accounts handled by registered representatives of the organization.")

Moreover, if the registered broker-dealer ignores indications of irregularity that should alert the registered broker-dealer to the likelihood that the foreign broker-dealer is taking advantage of U.S. customers or otherwise violating U.S. securities laws, and the registered broker-dealer nevertheless continues to effect questionable transactions on behalf of the foreign broker-dealer or its customers, the registered broker-dealer's role in the trades may give rise to possible violations of the federal securities laws.[153]

Finally, Rule 15a-6 as adopted does not allow banks to serve as the intermediary in transactions between U.S. institutional investors or major U.S. institutional investors and foreign broker-dealers. Despite the views expressed by several banks,[154] the Commission does not believe that it would be appropriate to permit any unregistered entity to perform this function, since this entity would not be subject to the Commission's extensive statutory authority to regulate, examine, and discipline registered broker-dealers.[155]

(2) Comments on U.S. institutional investor classifications. Proposed Rule 15a-6 would have allowed unregistered foreign broker-dealers to contact certain classes of U.S. institutional investors, which were limited to U.S. persons described in Rule 501(a) (1), (2), or (3) of Regulation D under the Securities Act[156] that, with the exception of registered broker-dealers, had total assets in excess of $100 million. These investors included domestic banks, savings and loan associations, brokers or dealers registered under section 15(b) of the Exchange Act,[157] insurance companies, registered investment companies, small business investment companies, employee benefit plans, private business development companies, and certain section 501(c)(3) organizations under the Internal Revenue Code.[158] Registered investment advisers were included as U.S. institutional investors within the rule if they had in excess of $100 million in assets under management. Further, if a registered investment company itself did not have total assets in excess of $100 million, it qualified as a U.S. institutional investor if it was part of a family of investment companies (as defined in the rule) that had total assets in excess of $100 million.

The expanded rule allowed direct contact with specified institutional investors, using the structure set out in the Chase Capital Markets U.S. letter.[159] Under the expanded rule, a foreign broker-dealer either could contact these institutional investors with the participation of an associated person supervised by a U.S. registered broker-dealer, or could contact major institutional investors directly. Similar conditions applied to both alternatives.

Six commenters opined that the definition of U.S. institutional investor should be expanded to include all accredited investors under Regulation D, regardless of assets.[160] In particular, the claim was made that persons qualifying as accredited investors under Regulation D, but with less than $100 million in assets, possessed adequate sophistication and judgment in financial matters to deal directly with foreign broker-dealers, consistent with their ability to make investment decisions without the disclosure afforded by the registration requirements of the Securities Act. It was averred that an asset test did not necessarily correlate with the degree of sophistication required to deal with unregistered foreign broker-dealers. Other commenters expressed a somewhat narrower view, asserting that the definition of U.S. institutional investor should be limited to institutional accredited investors.[161]

Alternatively, some commenters proposed other asset tests for major institutional investors, ranging from $1 million to 25 million in assets.[162] Another commenter suggested that, after a one-year trial period, the Commission consider broadening the definition of major U.S. institutional investor to include more institutions.[163] Finally, two commenters specifically said that the definition of U.S. institutional investor should include U.S. branches or agencies of foreign banks.[164]

As discussed in the Concept Release, the Commission recognizes that substantial institutional investors often have greater financial sophistication than individual investors. At the same time, the Commission does not believe that sophistication is in all circumstances an effective substitute for broker-dealer regulation. For example, systemic safeguards flowing from broker-dealer registration, such as financial responsibility requirements, are benefits that can be assured more effectively through governmental regulation.[165]

After considering the comments, the Commission has decided to retain the proposed rule's $100 million asset test for foreign broker-dealers contacting major U.S. institutional investors without an associated person of a registered broker-dealer participating in the contact.[166] As the Commission

[153] *Cf. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, Securities Exchange Act Release No. 19070 (Sept. 21, 1982), 26 SEC Docket 254 (continued execution of orders placed by investment adviser with discretion over account may subject broker-dealer to aiding and abetting liability, if broker-dealer has knowledge of improprieties in adviser's handling of account and adviser commits primary violation of securities laws).

[154] The Canadian Bankers Association, the Institute of International Bankers, and the Bank of America expressed the view that domestic banks should be permitted to serve as the U.S. intermediary for affiliated foreign broker-dealers. They claimed that, although U.S. banks are not registered with the Commission and thus, as pointed out by the ABA, are not subject to the Commission's regulatory, supervisory, or disciplinary authority, supervision by banking regulatory authorities would be an adequate substitute for Commission regulation.

[155] As explained below, however, the Commission has decided to include banks acting in broker or dealer capacity (including acting as municipal or government securities broker or dealer) in the category of persons with or for whom a foreign broker-dealer could effect, induce, or attempt to induce transactions and still qualify for an exemption from registration under the Rule.

[156] 17 CFR 230.501(a) (1), (2), or (3).

[157] 15 U.S.C. 78o(b).

[158] 26 U.S.C 501(c)(3).

[159] *Supra* note 130.

[160] CREF Continental Bank, the PSA, Westpac Banking Corporation, Chase Manhattan Government Securities, and Debevoise & Plimpton.

[161] The ABA, Sullivan & Cromwell, and Merrill Lynch. Continental Bank urged the Commission to adopt this approach if the Rule was not made applicable to all accredited investors.

[162] Security Pacific, the Institute of International Bankers, and the Toronto Stock Exchange.

[163] The NYSBA.

[164] The Institute of International Bankers and the NYSBA. In proposing Rule 15a-6, the Commission noted that accredited institutional investors under Regulation D included only domestic banks. Release 34-25801, 53 FR at 23654. *But see* note 168 *infra.*

[165] Similarly, in proposing Rule 144A, which would provide a safe-harbor exemption from the registration requirements of the Securities Act for resales of securities to institutional investors, the Commission sought to define a limited class of institutional investors that it could be "confident have extensive experience" in the market. Securities Act Release No. 6806 (Oct. 25, 1988), 53 FR 44016, 44028 ("Release 33-6806"). The Commission proposed to permit only a subset of institutions, those with over $100 million in assets, to resell securities free of resale restrictions. Release 33-6806, 53 FR at 44027-29. All comments received on proposed Rule 144A, together with a comment summary, are publicly available in File No. S7-23-88.

[166] Some commenters on proposed Rule 144A, *supra* note 165, suggested that the rule, if adopted, permit only those institutions with over $100 million in investment securities to resell securities free of resale restrictions. The staff is giving this suggestion serious consideration, in addition to considering other changes to the definition in Rule 144A of institutional investor including the scope of the term "family of investment companies that also appears in the Rule. If the Commission incorporates these changes into Rule 144A, then the Commission also will consider whether to incorporate similar standards into Rule 15a-6.

stated in proposing the rule, the asset test was based on the view that "direct U.S. oversight of the competence and conduct of foreign sales personnel may be of less significance where they are soliciting only U.S. institutional investors with high levels of assets," and the $100 million asset level was intended "to increase the likelihood that the institution or its investment advisers have prior experience in foreign markets that provides insight into the reliability and reputation" of foreign broker-dealers.[167]

Currently, the Commission continues to believe that institutions with this level of assets are more likely to have the skills and experience to assess independently the integrity and competence of the foreign broker-dealers providing this access. Moreover, these larger institutions have greater ability to demand information demonstrating the financial position of the foreign broker-dealer.

Accordingly, the Rule allows foreign broker-dealers to contact U.S. institutional investors with the participation of a U.S. associated person, and to contact independently U.S. institutional investors with over $100 million in assets or assets under management. The Rule thus adds the $100 million asset test to the U.S. institutional investor definition for certain purposes.[168]

[167] Release 34-25801, 53 FR at 23654.

[168] *See supra* note 108 and accompanying text regarding U.S. distribution of foreign research; *see infra* notes 178-80 and accompanying text regarding U.S. visits by foreign associated persons. The Rule also includes certain trusts recognized under Rule 501(a)(7), 17 CFR 230.501(a)(7), within the definition of U.S. institutional investor. In addition, when proposing Rule 15a-6, the Commission said that U.S. branches or agencies of foreign banks could not qualify as U.S. institutional investors, because Regulation D treated only domestic banks as accredited investors. *See supra* note 164. Rule 501(a)(1), 17 CFR 230.501(a)(1), refers to banks defined in section 3(a)(2) of the Securities Act, which generally means "any national bank, or any banking institution organized under the laws of any State, Territory, or the District of Columbia, the business of which is substantially confined to banking and is supervised by the State or territorial banking commission or similar official. 15 U.S.C. 77c(a)(2). In Release 33-6661, *supra* note 16, the Commission decided that U.S. branches or agencies of foreign banks subject to an appropriate level of U.S. banking regulation would be deemed "banks" for purposes of section 3(a)(2). A recent staff letter confirmed that U.S. branches and agencies of foreign banks satisfying the standards of Release No. 6661, so that their securities would be exempt from Securities Act registration by virtue of section 3(a)(2), are treated as accredited investors under Rule 501(a)(1). Letter from Richard K. Wulff, Chief, Office of Small Business Policy, Division of Corporation Finance, SEC, to Lawrence R. Uhlick, Esq., Institute of International Bankers (Jan. 4, 1989). Therefore, these U.S. branches and agencies of foreign banks are included in the definition of U.S. institutional investor in the Rule.

The Commission notes that the expanded rule deleted the language in the proposed rule that included the following in the definition of U.S. institutional investor: institutions organized or incorporated under the laws of the United States, its territories or possessions, or any state or the District of Columbia; institutions organized or incorporated under the laws of any foreign jurisdiction but conducting business principally in the United States; and branches of foreign entities located in the United States or its territories or possessions. The Commission has deleted these references from the Rule as unnecessary, because these entities already are included in the definition without regard to nationality. Accordingly, the use of the procedures specified in the exemptions under the Rule, in lieu of broker-dealer registration, would be required of foreign broker-dealers that solicited the permanent U.S. branches or agencies of any foreign entities.[169] This position is consistent with the general principles discussed above regarding foreign persons present in this country on other than a temporary basis.

(3) Operation. Paragraph (a)(3)(i) of the Rule sets forth the conditions to be met by a foreign broker-dealer wishing to engage in direct contacts with U.S. institutional investors or major U.S. institutional investors without registration. Paragraph (a)(3)(i)(A) requires the foreign broker-dealer to effect these transactions through a registered broker-dealer, as discussed below. Under paragraph (a)(3)(i)(B), the foreign broker-dealer must provide the Commission, upon request or pursuant to agreements reached between any "foreign securities authority" [170] and the Commission or the U.S. government, with any information or documents within the possession, custody, or control of the foreign broker-dealer, any testimony of foreign associated persons, and any assistance in taking the evidence of other persons, wherever located, that the Commission requests and that relates to transactions under the direct contact exemption under paragraph (a)(3) of the Rule. Unlike the proposed rule, however, these requirements are subject to an exception for information, documents, testimony, or assistance withheld in compliance with foreign blocking statutes or secrecy laws.

[169] *See supra* note 168 regarding U.S. branches and agencies of foreign banks.

[170] New section 3(a)(50) of the Exchange Act, 15 U.S.C. 78c(a)(50), defines this term to mean "any foreign government, or any governmental body or regulatory organization empowered by a foreign government to administer or enforce its laws as they relate to securities matters. *See* Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 101-704, section 6(a), 102 Stat. 4677, 4681.

If, after the foreign broker-dealer has exercised its best efforts to provide this information, documents, testimony, or assistance, which specifically includes requesting the appropriate foreign governmental body and, if legally necessary, its customers (with respect to customer information) to permit the foreign broker or dealer to provide the requested information, documents, testimony, or assistance to the Commission, the foreign broker-dealer is prohibited by applicable foreign law or regulations from satisfying the Commission's request, then it would continue to qualify for the exemption under paragraph (a)(3). Under paragraph (c), however, the Commission, after notice and opportunity for hearing, may withdraw the direct contact exemption under paragraph (a)(3) of the Rule with respect to the subsequent activities of the foreign broker-dealer, or class thereof, whose home country's law or regulations have prohibited the foreign broker-dealer from responding to the Commission's requests for information, documents, testimony, or assistance under paragraph (a)(3)(i)(B).

Several commenters suggested that the Commission not require foreign broker-dealers to comply with the requirements in paragraph (a)(3)(i)(B) to the extent that doing so actually would result in a violation of foreign blocking statutes, secrecy laws, or legal requirements to obtain the consent of foreign customers.[171] The Commission agrees with the commenters that automatic removal of a foreign broker-dealer from the Rule's protections would be inappropriate. Nevertheless, given the importance of the Commission's access to information, documents, testimony, and assistance concerning foreign broker-dealers' exempted activities for the Commission's enforcement of the U.S. securities laws, the Commission believes that foreign broker-dealers should be given strong incentives to use their best efforts to provide requested information, documents, testimony, and assistance to the Commission, including consulting with the foreign securities authority or other appropriate governmental body administering any relevant foreign law or regulations restricting compliance.

[171] Quayle, Union Bank of Switzerland, the Institute of International Bankers, the PSA, the SIA, James Capel, the ABA, Security Pacific, the NYSBA, and Sullivan & Cromwell.

Therefore, the Commission has retained these requirements in paragraph (a)(3), subject to an exception for information, documents, testimony, or assistance that the foreign broker-dealer has used its best efforts to provide, but has been prohibited from making available by foreign laws or regulations.[172] Moreover, the Commission would have the ability under paragraph (c) to remove the exemption for a foreign broker-dealer or class of foreign broker-dealers in circumstances where the Commission believes that its inability to obtain information, documents, testimony, or assistance because of foreign blocking statutes or secrecy laws raises serious investor protection or enforcement concerns. Under paragraph (c), the exemption under paragraph (a)(3) can be withdrawn only prospectively, and only by Commission order after notice and hearing, to which the usual procedural rights would attach.[173] In addition, Commission withdrawal of the exemption is discretionary, not mandatory, and it would be subject to the same review as other Commission orders.[174]

The requirements in paragraph (a)(3)(i)(B) of the Rule apply only to transactions effected under the provisions of paragraph (a)(3). As proposed by the Commission, these requirements would have applied to any transactions of a foreign broker-dealer with a U.S. institutional investor or the registered broker-dealer through which they were effected. The limitation in the Rule was suggested by several commenters.[175] The Commission does not wish to impose unnecessary burdens on foreign broker-dealers seeking to claim this exemption, and the Commission believes that it will be able to obtain the information necessary to carry out its enforcement responsibilities, with respect to a foreign broker-dealer's activities outside the Rule, through cooperation with foreign securities authorities.[176]

[172] If the Commission requested testimony of a foreign associated person who no longer was associated with the foreign broker-dealer, or who terminated association with the foreign broker-dealer after the Commission made its request, the Commission would consider the foreign broker-dealer to have complied with the Rule if it then used its best efforts to assist the Commission in taking the evidence of those persons.

[173] *See* 5 U.S.C. 554.

[174] *See* 5 U.S.C. 701-706.

[175] The Bank of America, Quayle, the PSA, the SIA, the ABA, Security Pacific, and Sullivan & Cromwell.

[176] *See* note 170 *supra.*

Paragraph (a)(3)(ii) of the Rule imposes requirements on foreign associated persons of the foreign broker-dealer. Paragraph (b)(2) of the Rule defines "foreign associated person" to mean any natural person resident outside the United States who is an associated person, as defined in section 3(a)(18) of the Exchange Act,[177] of a foreign broker-dealer, and who participates in the solicitation of a U.S. institutional investor or a major U.S. institutional investor under paragraph (a)(3) of the Rule. The Commission has adopted this definition from paragraph (b)(3) of the proposed rule, with the addition of the phrase "under paragraph (a)(3) of this rule for clarification.

Paragraph (a)(3)(ii)(A) of the Rule requires foreign associated persons of the foreign broker-dealer effecting transactions with U.S. institutional investors or major U.S. institutional investors to conduct all their securities activities from outside the United States,[178] with one exception. This exception allows a foreign associated person to conduct visits to U.S. institutional investors and major U.S. institutional investors within the United States, provided that the foreign associated person is accompanied on these visits by an associated person of a registered broker-dealer that accepts responsibility [179] for the foreign associated person's communications with these investors, and that transactions in any securities discussed by the foreign associated person are effected only through that registered broker-dealer pursuant to the provisions of paragraph (a)(3), not by the foreign broker-dealer. This exception has been added to the proposed rule in response to several comments that foreign associated persons should be allowed to visit U.S. institutions in this country, to create and sustain business relationships with these investors.[180] The proposed rule prohibited any U.S. activities by foreign associated persons, but the Commission believes that, where a registered broker-dealer is present and acts as an intermediary in the execution of orders, visits to these investors should be permitted.

Paragraph (a)(3)(ii)(B) of the Rule requires that foreign associated persons not be subject to a statutory disqualification specified in section 3(a)(39) of the Exchange Act,[181] or any substantially equivalent foreign (i) expulsion or suspension from membership, (ii) bar or suspension from association, (iii) denial of trading privileges, (iv) order denying, suspending, or revoking registration or barring or suspending association, or (v) finding with respect to causing any such effective foreign suspension, expulsion, or order; not have been convicted of any foreign offense, enjoined from any foreign act, conduct, or practice, or found to have committed any foreign act substantially equivalent to any of those listed in section 15(b)(4) (B), (C), (D), or (E) of the Exchange Act; [182] and not have been found to have made or caused to be made any false foreign statement or omission substantially equivalent to any of those listed in section 3(a)(39)(E) of the Exchange Act.[183] This language is a more complete description of the applicable disciplinary disqualifications cited in paragraph (a)(1)(ii) of the proposed rule and paragraph (b)(2)(ii) of the expanded rule, both of which referred to violations of substantially equivalent foreign statutes or regulations.[184]

Finally, paragraph (a)(3)(iii) of the Rule requires the use of a registered broker-dealer as an intermediary in effecting trades between U.S. institutional investors or major U.S. institutional investors and the foreign broker-dealer as a condition for this exemption. Paragraph (a)(3)(iii)(A) first requires that transactions with these investors be effected through the

[177] 15 U.S.C. 78c(a)(18).

[178] Paragraph (b)(6) of the Rule defines the term "United States" to mean the United States of America, including the states and any territories and other areas subject to its jurisdiction. This definition has been adopted from paragraph (c)(6) of the expanded rule, and the term is not defined in the Exchange Act or the rules thereunder. Section 3(a)(16) of the Exchange Act, however, already defines "State" to mean "any State of the United States, the District of Columbia, Puerto Rico, the Virgin Islands, or any other possession of the United States. 15 U.S.C. 78c(a)(16).

[179] The Commission would expect the associated person to be familiar with the foreign broker-dealer's research reports discussed during these visits, to conduct prior review of any written materials to be distributed during the visits, along with summaries or outlines of the foreign associated person's oral presentation, and to know whether the foreign associated person's statements were consistent with the foreign broker-dealer's current recommendations. In general, the Commission's expectations regarding the responsibility imposed on the registered broker-dealer and discharged through its associated person during these visits would be the same as those regarding the responsibility of registered broker-dealer in connection with the distribution of research to U.S. institutional investors. *See supra* note 116.

[180] Quayle, the PSA, Chase Manhattan Government Securities, the ABA, the SIA, Security Pacific, the NYSBA, Sullivan & Cromwell, and Merrill Lynch.

[181] 15 U.S.C. 78c(a)(39).

[182] 15 U.S.C. 78*o*(b)(4) (B), (C), (D), or (E).

[183] 15 U.S.C. 78c(a)(39)(E).

[184] *See* proposed International Securities Enforcement Cooperation Act of 1989, H.R. 1396, 101st Cong., 1st Sess., 135 Cong. Rec. 790 (1989); sections 3 and 4.

registered broker-dealer. This means that the registered broker-dealer must handle all aspects of these transactions except the negotiation of their terms,[185] which may occur between the investors and the foreign broker-dealer (through its foreign associated persons).

Paragraph (a)(3)(iii)(A) requires the registered broker-dealer through which transactions with these investors are effected to be responsible for carrying out specified functions, so as to make the performance of these functions subject to direct Commission oversight. The registered broker-dealer must issue all required confirmations [186] and account statements to the investors. These documents are significant points of contact between the investor and the broker-dealer, and they provide important information. Also, as between the foreign broker-dealer and the registered broker-dealer, the latter is required to extend or arrange for the extension of any credit to these investors in connection with the purchase of securities.[187] In addition, the registered broker-dealer is responsible for maintaining required books and records relating to the transactions conducted under paragraph (a)(3) of the Rule, including those required by Rules 17a-3 and 17a-4,[188] which facilitates Commission supervision and investigation of these transactions.[189] As adopted, the functions required of the registered broker-dealer in paragraph (a)(3)(iii)(A) are taken from the proposed rule, with some exceptions.[190]

Paragraph (a)(4)(iii)(B) of the Rule requires the registered broker-dealer to participate through an associated person in all oral communications between foreign associated persons and U.S. institutional investors. By virtue of this participation, the registered broker-dealer would become responsible for the content of these communications, and the Commission's statements regarding the nature and discharge of similar responsibilities regarding the distribution of research and U.S. visits by foreign associated persons would apply.[191]

The requirement in paragraph (a)(4)(iii)(C) of the Rule for the registered broker-dealer to obtain from the foreign broker-dealer, for each foreign associated person, the information specified in Rule 17a-3(a)(12),[192] including sanctions imposed by foreign securities authorities, exchanges, or associations (including without limitation those described in paragraph (a)(3)(ii)(B) of the Rule), also has been drawn from the proposed rule. In addition, paragraph (a)(3)(iii)(D) of the Rule requires the registered broker-dealer to obtain from the foreign broker-dealer and each foreign associated person written consent to service of process for any civil action brought by or proceeding before the Commission or any SRO, as defined in section 3(a)(26) of the Exchange Act,[193] stating that process may be served on the registered broker-dealer as provided on that broker-dealer's current Form BD. This language follows the text of the proposed rule. Some commenters argued that both the information provision and consent requirements as proposed were overbroad and would restrict use of the Rule,[194] but the Commission does not believe that it is desirable to draw the requirement to consent to service of process more narrowly to relate only to transactions effected in reliance on the Rule's intermediary exemption.

Further, paragraph (a)(3)(iii)(E) of the Rule requires the registered broker-dealer to maintain a written record of the information and consents required by paragraphs (a)(3)(iii) (C) and (D),[195] and all records in connection with trading activities of U.S. institutional investors or major U.S. institutional investors involving the foreign broker-dealer conducted under paragraph (a)(3) of the Rule, in an office of the registered broker-dealer located in the United States (thus, with respect to nonresident U.S. broker-dealers, pursuant to Rule 17a-7(a)) [196] and make these records available to the Commission upon request. This language follows the proposed rule, with the exception of the reference to nonresident registered broker-dealers. One commenter suggested that these broker-dealers should be allowed to serve as intermediary registered broker-dealers under the Rule,[197] and the Commission agrees, as stated above. The Commission attaches considerable importance, however, to preserving its access to records relating to activities conducted under paragraph (a)(3). These records will enable the Commission to carry out its enforcement responsibilities and exercise its supervision over the registered broker-dealer intermediary. This intermediary, therefore, whether resident or nonresident, must maintain all the records called for by the Rule in an office within the territorial limits of the United States.[198]

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[185] Of course, the rules of foreign securities exchanges and over-the-counter markets may require the foreign broker-dealer, as a member or market maker, to perform the actual physical execution of transactions in foreign securities listed on those exchanges or traded in those markets. The Rule would permit the foreign broker-dealer to perform this function.

[186] *See* Rule 10b-10, 17 CFR 240.10b-10. The confirmation requirements imposed by Rule 10b-10 are a significant antifraud measure.

[187] The extensive U.S. regulation of these functions is intended to protect both U.S. investors and securities markets. *See, e.g.*, sections 7(c) and 11(d) of the Exchange Act, 17 U.S.C. 78g(c) and 78k(d), and the rules and regulations thereunder, *e.g.*, Regulation T, 17 CFR 220.1-220.18, and Rule 11d1-2, 17 CFR 240.11d1-2.

[188] 17 CFR 240.17a-3 and 17a-4. *But see* note 150 *supra* and accompanying text concerning delegation of data processing functions to the foreign broker-dealer.

[189] Of course, because the registered broker-dealer would "book" Rule 15a-6 trades as its own, it would be required to comply with the provisions of Rule 15c3-1, 17 CFR 240.15c3-1, the Commission's net capital rule, with respect to these transactions, and it would be responsible for receiving, delivering, and safeguarding funds and securities on behalf of the investors pursuant to Rule 15c3-3, 17 CFR 240.15c3-3. Merrill Lynch believed that it should be permissible for foreign custodian banks to handle the clearance and settlement of foreign securities transactions by the investors under the Rule. The Commission notes that Rule 15c3-3(c)(4), 17 CFR 240.15c3-3(c)(4), already permits the use of designated foreign control locations deemed satisfactory by the Commission for purposes of compliance with that rule. Sullivan & Cromwell spoke without elaboration of a registered broker-dealer that "introduced" its U.S. customers to a foreign broker-dealer. If this term signified the presence of an introducing-clearing relationship, where the foreign broker-dealer held U.S. customers' funds and securities, registration of the foreign broker-dealer would be required. *See* Part III.B. *supra*.

[190] Like paragraph (b)(3) of the expanded rule, the Rule deletes as unnecessary the express requirement that the registered broker-dealer effect transactions "with or for" the U.S. institutional investor or the major U.S. institutional investor. As explained above, paragraph (a)(4)(i)(A) of the Rule already requires the foreign broker-dealer to effect, transactions "through" the registered broker-dealer. The phrase "as between the foreign broker or dealer and the registered broker or dealer" in paragraph (a)(3)(iii)(A)(*3*) concerning extension of credit, found in paragraph (b)(3)(i)(B) of the expanded rule, has been added for clarification.

[191] *See supra* notes 116 and 179. This requirement for "participation" under the Rule would be satisfied if the associated person of the registered broker-dealer was present, either physically or telephonically, during these oral communications, and was able to take part in them as they occurred.

[192] 17 CFR 240.17a-3(a)(12). Rule 17a-3(a) also requires that this information be kept current. 17 CFR 240.17a-3(a).

[193] 15 U.S.C. 78c(a)(26).

[194] The SIA, the ABA, Security Pacific, and Sullivan & Cromwell.

[195] The Commission notes that SROs exercising their authority to inspect their members performing the intermediary function under the Rule should examine the records of the information and the consents required by the Rule. The Commission would encourage these SROs to consider whether it would be more efficient for them to adopt specific rules requiring those members to file these records with the SROs soon after obtaining the required information and consents.

[196] 17 CFR 240.17a-7(a).

[197] Quayle.

[198] Nonresident registered broker-dealers still could maintain other records outside the United

Continued

b. Transactions with Certain Persons. Paragraph (a)(4) of the Rule provides an exemption for a second type of direct contact by broker-dealers. It exempts foreign broker-dealers that effect any transactions in securities with or for, or induce or attempt to induce the purchase or sale of any securities by, the following defined classes of persons.[199]

(1) Registered broker-dealers and banks. Paragraph (a)(4)(i) includes registered brokers or dealers, whether acting as principal for their own account or as agent for others. This exemption was in paragraph (a)(1)(iii) of the expanded rule. Commenters argued that, while the proposed interpretive statement said that a foreign broker-dealer could purchase U.S. securities from a registered broker-dealer for resale to foreign investors without registering with the Commission,[200] it created a misimpression by not also stating that foreign broker-dealers could sell securities to registered broker-dealers without registration[201] In response, the Commission expressly has exempted trades of foreign broker-dealers with registered broker-dealers and with banks acting in a broker or dealer capacity.[202] The Commission notes that the staff has taken no-action positions regarding foreign broker-dealers effecting transactions with or for both registered broker-dealers and banks acting in a broker or dealer capacity as permitted by U.S statutory and regulatory provisions,[203] and it has reflected this position in the Rule.

The Commission does not intend this exemption to permit the foreign broker-dealer to act as a dealer in the United States through an affiliated registered broker-dealer.[204] The Commission recognizes that dealers in foreign markets may transmit securities positions to U.S. broker-dealer affiliates after the foreign markets close, so that the U.S. affiliates can continue trading those securities. If, however, the foreign broker-dealer controlled the registered broker-dealer's day-to-day market making activities by explicit restrictions on the U.S. broker-dealer's ability to execute orders against the foreign broker-dealer's positions or to take independent positions, the foreign broker-dealer could be considered a dealer subject to U.S. broker-dealer registration requirements.[205]

(2) International organizations. Paragraph (a)(4)(ii) of the Rule exempts foreign broker-dealers that deal with certain international organizations, regardless of their location or whether the U.S. jurisdictional means are implicated. They include the African Development Bank, the Asian Development Bank, the Inter-American Development Bank, the International Bank for Reconstruction and Development, the International Monetary Fund, the United Nations, and their agencies, affiliates, and pension funds. These are the same international organizations specified in proposed Regulation S,[206] together with their pension funds, as suggested by several commenters.[207]

(3) Foreign persons temporarily present in the United States. Paragraph (a)(4)(iii) of the Rule includes any foreign person temporarily present in the United States, with whom the foreign broker-dealer had a bona fide, pre-existing relationship before the foreign person entered the United States. This paragraph codifies part of the proposed interpretive statement,[208] and is taken from paragraph (a)(1)(v) of the expanded rule, with one exception. The phrase "before the foreign person entered the United States" has been added to clarify the nature of the relationship. The Commission is of the view that a foreign broker-dealer that solicits or engages in securities transactions with or for these persons while they are temporarily present in this country need not register with the Commission.[209]

One commenter asked the Commission to define U.S. residency for purposes of compliance with this and other exemptions in the Rule.[210] The Commission does not believe that it would be appropriate to establish a separate standard of residency for the purpose of claiming this exemption different from those generally established under state or federal law.[211] As stated in Release 34-25801, questions regarding the temporary nature of a person's presence in this country would be fact-specific.[212] The Commission would take the position, however, that a foreign person not otherwise deemed a resident of the United States under applicable law would be presumed to be temporarily present in this country for the purpose of paragraph (a)(3) of the Rule. This presumption, of course, would be subject to rebuttal in light all of the facts and circumstances surrounding that

States, provided that the conditions of Rule 17a-7(b) were met. *See* 17 CFR 240.17a-7(b).

[199] The Division of Investment Management generally would expect to respond favorably to no-action requests regarding registration as an investment adviser from foreign broker-dealers complying with the provisions of paragraph (a)(4) of the Rule. *See supra* notes 123-26 and accompanying text.

[200] Release 34-25801, 53 FR at 23646.

[201] The Institute of International Bankers, the ABA, the SIA, Security Pacific, and Sullivan & Cromwell.

[202] The exemption allows foreign broker-dealers to effect transactions with or for certain banks or registered broker-dealers; direct contact by the foreign broker-dealers with the U.S. customers of the registered broker-dealers or banks, however, would not be covered by this exemption.

[203] Security Pacific Corporation and National Westminster Bank letters, *supra* note 68.

[204] *See* note 205 *infra*.

[205] *See, e.g.*, the Vickers da Costa/Citicorp order, *supra* note 131, which exempted several related foreign broker-dealers from U.S. broker-dealer registration requirements. Because of Glass-Steagall Act restrictions applicable to the U.S. affiliate, *see* 12 U.S.C. 24 and 378, the foreign broker-dealers agreed to provide the U.S. affiliate with standing orders to buy and sell the securities in which the U.S. affiliate previously had acted as a market maker. Thus, the U.S. affiliate's quote in NASDAQ always would reflect a previously entered firm order from the foreign broker-dealers. The U.S. affiliate's activities would be limited to executing, on a riskless principal basis, any orders received from U.S. customers against these orders. This arrangement was approved by the Comptroller of the Currency. Letter from Judith A. Walter, Senior Deputy Comptroller, to Ellis E. Bradford, Vice President, Citibank, N.A. (June 13, 1986).

In its exemptive order, the Commission allowed the foreign broker-dealers to buy and sell simultaneously on a continuing basis through the U.S. affiliate without registering in the United States as broker-dealers. However, the Commission imposed a number of limitations to provide additional regulatory safeguards. The foreign broker-dealers' control over the price and size of their standing orders was limited in order to give the U.S. affiliate some discretion in its trading activities. The U.S. affiliate also agreed to satisfy additional net capital requirements intended to increase its ability to meet its settlement obligations upon failure of the foreign broker-dealers. In addition, the parent of the broker-dealers represented that information regarding the trading activities of the foreign broker-dealers would be made available to the Commission in connection with any investigation, and that it would attempt to obtain customer consent to release of information concerning their trading, if requested. Finally, the parent agreed that it would be designated as the foreign broker-dealers' agent for service of process in any proceeding or other action involving the foreign broker-dealers. The foreign broker-dealers also limited their securities activities in the United States to those enumerated in the letter, and the parent represented that the foreign broker-dealers would not engage in any securities business with U.S. citizens.

[206] Release 33-6779, 53 FR at 22677.

[207] The SIA, the ABA, and Sullivan & Cromwell.

[208] Release 34-25801, 53 FR at 23649. *See also* Security Pacific and National Westminster Bank letters, *supra* note 68.

[209] This position is consistent with the proposal of the American Law Institute that a nonresident broker-dealer that "does business with non-national of the United States who is present as a nonresident within the United States and was previously customer or client" should not be subject to U.S. broker-dealer jurisdiction. *ALI Federal Securities Code* § 1905(b)(2)(B) (1980). Professor Loss, the reporter for the Code, uses the example of "Canadian broker who uses the telephone to service a customer who is vacationing in Florida."*Id.* at Comment 9.

[210] The NYSBA.

[211] *See generally, e.g.*, section 911 of the Internal Revenue Code, 26 U.S.C. 911, which provides certain exclusions from the gross income of U.S. citizens resident abroad.

[212] 53 FR at 23649.

foreign person's presence in the United States.

(4) Foreign agencies or branches of U.S. persons. The proposed rule and the expanded rule both provided an exemption for foreign broker-dealers effecting or soliciting transactions by agencies or branches of U.S. persons, which were located outside the United States and were operated for valid business reasons. The Commission has retained this exemption in the Rule to clarify that foreign broker-dealers that deal outside the United States with branches and agencies having an established location outside the United States do not need to register with the Commission, provided that the transactions occur outside the United States.

Commenters suggested that the presence of a valid business purpose was unnecessary in the broker-dealer context. [213] The Commission agrees. The Rule's exemption for unsolicited trades reflects the view that U.S. persons seeking out unregistered foreign broker-dealers outside the U.S. cannot expect the protection of U.S. broker-dealer standards. The Commission believes that this rationale applies equally to U.S. branches and agencies established overseas that choose to deal with unregistered foreign broker-dealers.[214]

(5) Nonresident U.S. citizens. Finally, paragraph (a)(4)(v) of the Rule includes U.S. citizens resident outside the United States, provided that the foreign broker-dealer does not direct its selling efforts toward identifiable groups of U.S. citizens resident abroad.[215] Like the exemption regarding foreign branches and agencies of U.S. persons, all transactions must occur outside the United States. As discussed above in Part III.B., neither U.S. citizens resident abroad nor foreign broker-dealers normally would expect that the U.S. broker-dealer registration requirements would be triggered by non-U.S. securities transactions between them.

V Conclusion

The Commission believes that the conditional exemptions in Rule 15a–6 for foreign broker-dealers engaging in certain activities involving U.S. investors and securities markets will reduce the costs and increase the efficiency of international securities transactions as well as facilitate the international flow of information. The differing procedures in the Rule for nondirect and direct contacts by foreign broker-dealers with U.S. investors also will facilitate the access of U.S. investors to foreign securities markets through those foreign broker-dealers and the research that they provide, consistent with the regulatory safeguards afforded by broker-dealer registration. In light of the importance that the Commission attaches to broker-dealer registration and regulation in the international context, the Commission believes that the exemptions in Rule 15a–6 are in the public interest and consistent with the protection of U.S. investors.

VI. Effects on Competition and Regulatory Flexibility Act Certification

Section 23(a)(2) of the Exchange Act [216] requires that the Commission, when adopting rules under the Exchange Act, consider the anticompetitive effects of those rules, if any, and balance any anticompetitive impact against the regulatory benefits gained in terms of furthering the purposes of the Exchange Act. The Commission believes that adoption of the Rule will not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act, especially since the Rule provides exemptions for eligible foreign broker-dealers from the broker-dealer registration requirements under the Exchange Act.

Pursuant to section 3(b) of the Regulatory Flexibility Act,[217] when the Commission proposed Rule 15a–6 Chairman Ruder certified that the proposed rule, if adopted, would not have a significant economic impact on a substantial number of small entities.[218] The Commission did not receive any comments on the Chairman's certification.

List of Subjects in 17 CFR Part 240

Reporting and recordkeeping requirements, Securities.

VII. Statutory Basis and Text of Amendments

The Commission hereby amends Part 240 of Chapter II of Title 17 of the Code of Federal Regulations as follows:

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

1. The authority citation for Part 240 is amended by adding the following citation:

Authority: Sec. 23, 48 Stat. 901, as amended (15 U.S.C. 78w) § 240.15a–6, also issued under secs. 3, 10, 15, and 17 15 U.S.C. 78c, 78j, 78*o*, and 78q;

2. By adding § 240.15a–6 after the undesignated heading as follows:

Registration of Brokers and Dealers

§ 240.15a–6 Exemption of certain foreign brokers or dealers.

(a) A foreign broker or dealer shall be exempt from the registration requirements of sections 15(a)(1) or 15B(a)(1) of the Act to the extent that the foreign broker or dealer:

(1) Effects transactions in securities with or for persons that have not been solicited by the foreign broker or dealer; or

(2) Furnishes research reports to major U.S. institutional investors, and effects transactions in the securities discussed in the research reports with or for those major U.S. institutional investors, provided that:

(i) The research reports do not recommend the use of the foreign broker or dealer to effect trades in any security;

(ii) The foreign broker or dealer does not initiate contact with those major U.S. institutional investors to follow up on the research reports, and does not otherwise induce or attempt to induce the purchase or sale of any security by those major U.S. institutional investors;

(iii) If the foreign broker or dealer has a relationship with a registered broker or dealer that satisfies the requirements of paragraph (a)(3) of this section, any transactions with the foreign broker or dealer in securities discussed in the research reports are effected only through that registered broker or dealer, pursuant to the provisions of paragraph (a)(3) of this section; and

(iv) The foreign broker or dealer does not provide research to U.S. persons pursuant to any express or implied understanding that those U.S. persons will direct commission income to the foreign broker or dealer; or

(3) Induces or attempts to induce the purchase or sale of any security by a U.S. institutional investor or a major U.S. institutional investor, provided that:

(i) The foreign broker or dealer:

(A) Effects any resulting transactions with or for the U.S. institutional investor or the major U.S. institutional investor through a registered broker or dealer in

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[213] The SIA, the ABA, and Sullivan & Cromwell.

[214] The Commission has deleted the exemption in the proposed rule that referred to affiliates or subsidiaries of U.S. persons that were located outside this country and organized or incorporated under the laws of any foreign jurisdiction. The Commission has decided that this exemption is unnecessary, since these entities should not properly be regarded as U.S. persons.

[215] *See supra* note 51 and accompanying text.

[216] 15 U.S.C. 78w(a)(2).

[217] 5 U.S.C. 603(b).

[218] Release 34–25801, 53 FR at 23655.

the manner described by paragraph (a)(3)(iii) of this section; and

(B) Provides the Commission (upon request or pursuant to agreements reached between any foreign securities authority, including any foreign government, as specified in section 3(a)(50) of the Act, and the Commission or the U.S. Government) with any information or documents within the possession, custody, or control of the foreign broker or dealer, any testimony of foreign associated persons, and any assistance in taking the evidence of other persons, wherever located, that the Commission requests and that relates to transactions under paragraph (a)(3) of this section, except that if, after the foreign broker or dealer has exercised its best efforts to provide the information, documents, testimony, or assistance, including requesting the appropriate governmental body and, if legally necessary, its customers (with respect to customer information) to permit the foreign broker or dealer to provide the information, documents, testimony, or assistance to the Commission, the foreign broker or dealer is prohibited from providing this information, documents, testimony, or assistance by applicable foreign law or regulations, then this paragraph (a)(3)(i)(B) shall not apply and the foreign broker or dealer will be subject to paragraph (c) of this section;

(ii) The foreign associated person of the foreign broker or dealer effecting transactions with the U.S. institutional investor or the major U.S. institutional investor:

(A) Conducts all securities activities from outside the U.S., except that the foreign associated persons may conduct visits to U.S. institutional investors and major U.S. institutional investors within the United States, provided that:

(*1*) The foreign associated person is accompanied on these visits by an associated person of a registered broker or dealer that accepts responsibility for the foreign associated person's communications with the U.S. institutional investor or the major U.S institutional investor; and

(*2*) Transactions in any securities discussed during the visit by the foreign associated person are effected only through the registered broker or dealer, pursuant to paragraph (a)(3) of this section; and

(B) Is determined by the registered broker or dealer to:

(*1*) Not be subject to a statutory disqualification specified in section 3(a)(39) of the Act, or any substantially equivalent foreign

(*i*) Expulsion or suspension from membership,

(*ii*) Bar or suspension from association,

(*iii*) Denial of trading privileges,

(*iv*) Order denying, suspending, or revoking registration or barring or suspending association, or

(*v*) Finding with respect to causing any such effective foreign suspension, expulsion, or order;

(*2*) Not to have been convicted of any foreign offense, enjoined from any foreign act, conduct, or practice, or found to have committed any foreign act substantially equivalent to any of those listed in sections 15(b)(4) (B), (C), (D), or (E) of the Act; and

(*3*) Not to have been found to have made or caused to be made any false foreign statement or omission substantially equivalent to any of those listed in section 3(a)(39)(E) of the Act; and

(iii) The registered broker or dealer through which the transaction with the U.S. institutional investor or the major U.S. institutional investor is effected:

(A) Is responsible for:

(*1*) Effecting the transactions conducted under paragraph (a)(3) of this section, other than negotiating their terms;

(*2*) Issuing all required confirmations and statements to the U.S. institutional investor or the major U.S. institutional investor;

(*3*) As between the foreign broker or dealer and the registered broker or dealer, extending or arranging for the extension of any credit to the U.S. institutional investor or the major U.S. institutional investor in connection with the transactions;

(*4*) Maintaining required books and records relating to the transactions, including those required by Rules 17a-3 and 17a-4 under the Act (17 CFR 2410.17a-3 and 17a-4);

(*5*) Complying with Rule 15c3-1 under the Act (17 CFR 240.15c3-1) with respect to the transactions; and

(*6*) Receiving, delivering, and safeguarding funds and securities in connection with the transactions on behalf of the U.S. institutional investor or the major U.S. institutional investor in compliance with Rule 15c3-3 under the Act (17 CFR 240.15c3-3);

(B) Participates through an associated person in all oral communications between the foreign associated person and the U.S. institutional investor, other than a major U.S. institutional investor;

(C) Has obtained from the foreign broker or dealer, with respect to each foreign associated person, the types of information specified in Rule 17a-3(a)(12) under the Act (17 CFR 240.17a-3(a)(12)), provided that the information required by paragraph (a)(12)(d) of that Rule shall include sanctions imposed by foreign securities authorities, exchanges, or associations, including without limitation those described in paragraph (a)(3)(ii)(B) of this section;

(D) Has obtained from the foreign broker or dealer and each foreign associated person written consent to service of process for any civil action brought by or proceeding before the Commission or a self-regulatory organization (as defined in section 3(a)(26) of the Act), providing that process may be served on them by service on the registered broker or dealer in the manner set forth on the registered broker's or dealer's current Form BD; and

(E) Maintains a written record of the information and consents required by paragraphs (a)(3)(iii) (C) and (D) of this section, and all records in connection with trading activities of the U.S. institutional investor or the major U.S. institutional investor involving the foreign broker or dealer conducted under paragraph (a)(3) of this section, in an office of the registered broker or dealer located in the United States (with respect to nonresident registered brokers or dealers, pursuant to Rule 17a-7(a) under the Act (17 CFR 240.17a-7(a))), and makes these records available to the Commission upon request; or

(4) Effects transactions in securities with or for, or induces or attempts to induce the purchase or sale of any security by:

(i) A registered broker or dealer, whether the registered broker or dealer is acting as principal for its own account or as agent for others, or a bank acting in a broker or dealer capacity as permitted by U.S. law;

(ii) The African Development Bank, the Asian Development Bank, the Inter-American Development Bank, the International Bank for Reconstruction and Development, the International Monetary Fund, the United Nations, and their agencies, affiliates, and pension funds;

(iii) 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;

(iv) Any agency or branch of a U.S. person permanently located outside the United States, provided that the transactions occur outside the United States; or

(v) U.S. citizens resident outside the United States, provided that the transactions occur outside the United States, and that the foreign broker or

dealer does not direct its selling efforts toward identifiable groups of U.S. citizens resident abroad.

(b) When used in this rule,

(1) The term "family of investment companies" shall mean:

(i) Except for insurance company separate accounts, any two or more separately registered investment companies under the Investment Company Act of 1940 that share the same investment adviser or principal underwriter and hold themselves out to investors as related companies for purposes of investment and investor services; and

(ii) With respect to insurance company separate accounts, any two or more separately registered separate accounts under the Investment Company Act of 1940 that share the same investment adviser or principal underwriter and function under operational or accounting or control systems that are substantially similar.

(2) The term "foreign associated person" shall mean any natural person domiciled outside the United States who is an associated person, as defined in section 3(a)(18) of the Act, of the foreign broker or dealer, and who participates in the solicitation of a U.S. institutional investor or a major U.S. institutional investor under paragraph (a)(3) of this section.

(3) The term "foreign broker or dealer" shall 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 Act.

(4) The term "major U.S. institutional investor" shall 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.

(5) The term "registered broker or dealer" shall mean a person that is registered with the Commission under sections 15(b), 15B(a)(2), or 15C(a)(2) of the Act.

(6) The term "United States" shall mean the United States of America, including the States and any territories and other areas subject to its jurisdiction.

(7) The term "U.S. institutional investor" shall 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)).

(c) The Commission, by order after notice and opportunity for hearing, may withdraw the exemption provided in paragraph (a)(3) of this section with respect to the subsequent activities of a foreign broker or dealer or class of foreign brokers or dealers conducted from a foreign country, if the Commission finds that the laws or regulations of that foreign country have prohibited the foreign broker or dealer, or one of a class of foreign brokers or dealers, from providing, in response to a request from the Commission, information or documents within its possession, custody, or control, testimony of foreign associated persons, or assistance in taking the evidence of other persons, wherever located, related to activities exempted by paragraph (a)(3) of this section.

By the Commission.

Jonathan G. Katz,

Secretary.

July 11, 1989.

[FR Doc. 89-16725 Filed 7-17-89; 8:45 am]

BILLING CODE 8010-01-M

UNITED STATES INFORMATION AGENCY

22 CFR Part 514

Exchange-Visitor Program; Extension of Stay—Exchange Visitors From the People's Republic of China

AGENCY: United States Information Agency.

ACTION: Temporary rule.

SUMMARY: This notice amends the regulations found at 22 CFR 514.23, General limitations of stay, to permit the extension of the authorized duration of stay for one year for exchange visitors from the People's Republic of China who entered the United States on or before June 6, 1989, and whose authorized period of stay will expire before June 6, 1990. This action is taken in consonance with the current foreign policy of the United States as evidenced by the White House of June 5.

EFFECTIVE DATES: This temporary rule is effective from June 6, 1989, and shall remain in effect until June 6, 1990.

ADDRESS: Merry Lymn, Assistant General Counsel, Office of the General Counsel, Room 700, United States Information Agency, 301 4th Street SW., Washington, DC 20547

FOR FURTHER INFORMATION CONTACT: Merry Lymn, Assistant General Counsel, Office of the General Counsel, Room 700, United States Information Agency, 301 4th Street SW., Washington, DC 20547 (202) 485-8829.

SUPPLEMENTARY INFORMATION: In furtherance of the foreign policy, the Agency amends the prescribed duration of stay in 22 CFR 514.23 to permit a one-year extension for exchange visitors from the People's Republic of China whose authorized period of stay will expire before June 6, 1990.

This modification of the rule will enable exchange visitors from the People's Republic of China to maintain their current J-visa status by applying to the Immigration and Naturalization Service for an extension. It does not apply to exchange visitors from the People's Republic of China arriving in the United States after June 6, 1989. Changes of category or program objective will not be permitted for exchange visitors whose stay is extended under this rule.

Program sponsors may issue a new IAP-66 form to exchange visitors from the People's Republic of China to permit the one-year extension of the J-1 status in accordance with this temporary rule.

This action is taken without regard to the notice and comment provisions of the Administrative Procedure Act, 5 U.S.C. 553, as it comes within the exception at 5 U.S.C. 553(a)(1), a "foreign affairs function of the United States. Further, because of the immediacy of the problem of exchange visitors from the People s Republic of China whose authorized stay will expire momentarily, notice and public comment thereon are impracticable and unnecessary.

List of Subjects in 14 CFR Part 71

Aviation safety, VOR Federal airways.

The Proposed Amendment

Accordingly, pursuant to the authority delegated to me, the Federal Aviation Administration proposes to amend Part 71 of the Federal Aviation Regulations (14 CFR Part 71) as follows:

PART 71—DESIGNATION OF FEDERAL AIRWAYS, AREA LOW ROUTES, CONTROLLED AIRSPACE, AND REPORTING POINTS

1. The authority citation for Part 71 continues to read as follows:

Authority: 49 U.S.C. 1348(a), 1354(a), 1510; Executive Order 10854; 49 U.S.C. 106(g) (Revised Pub. L. 97-449, January 12, 1983); 14 CFR 11.69.

§ 71.123 [Amended]

2. Section 71.123 is amended as follows:

V-441 [Amended]

By removing the words "to Ocala." and substituting the words "Ocala; Gainesville, FL; INT Gainesville 017°T(016°M) and Brunswick, GA, 223°T(227°M) radials; Brunswick; INT Brunswick 052°T(056°M) and Savannah, GA, 180°T(181°M) radials; to Savannah."

Issued in Washington, DC, On June 8, 1988.

Temple H. Johnson,

Manager, Airspace-Rules and Aeronautical Information Division.

[FR Doc. 88-14171 Filed 6-22-88; 8:45 am]

BILLING CODE 4910-13-M

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

[Release No. 34-25801 File No. S7-11-88]

Registration Requirements for Foreign Broker-Dealers

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rulemaking.

SUMMARY: The Commission is issuing for comment a staff interpretive statement regarding the applicability of U.S. broker-dealer registration requirements to foreign entities engaged in securities activities involving U.S. investors. This staff position is published for comment preparatory to publishing a Commission interpretive statement on this subject. In addition, the Commission is publishing a proposed rule that would exempt from broker-dealer registration foreign entities that deal with specified U.S. persons under limited conditions. The proposed rule is developed from previous staff interpretive positions. The Commission is taking these actions in response to the cross-border activities of foreign broker-dealers.

DATE: Comments should be submitted by September 15, 1988.

ADDRESSES: Interested persons should submit three copies of their views to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Mail Stop 6-9, Washington, DC 20549, and should refer to File No. S7-11-88. All submissions will be available for public inspection at the Commission's Public Reference Branch, 450 Fifth Street, NW., Washington, DC 20549.

FOR FURTHER INFORMATION CONTACT: Robert L.D. Colby, Chief Counsel ((202) 272-2844), or John Polanin, Jr., Attorney ((202) 272-2848), Office of Legal Policy, Division of Market Regulation, Securities and Exchange Commission, 450 Fifth Street, NW., Mail Stop 5-1, Washington, DC 20549.

SUPPLEMENTARY INFORMATION:

I. Introduction

Section 15(a) of the Securities Exchange Act of 1934 ("Exchange Act") generally requires that any broker [1] or dealer [2] using the mails or any means or instrumentality of interstate commerce (referred to as the jurisdictional means) [3] must register as a broker-dealer with the Commission. From time to time, foreign entities involved in a variety of securities activities have requested no-action and interpretive advice from the staff of the Division of Market Regulation ("staff") regarding whether certain international securities activities required broker-dealer registration with the Commission. The recent expansion and increased complexity of the world's securities markets have resulted in a significant increase in the number of inquiries that the staff has received. Accordingly, the Commission is concerned that foreign-based broker-dealers, foreign affiliates of U.S. broker-dealers, and other foreign financial institutions [4] may not clearly understand the application of U.S. broker-dealer registration requirements. Part II of this release reviews past interpretive and exemptive positions regarding the necessity for broker-dealer registration [5] by foreign entities. Part III provides a staff summary of its current positions, and requests comment on the Commission's proposed adoption of these positions as its own interpretive views. Part IV of the release solicits comment on a proposed rule, developed from these positions, that would exempt from the broker-dealer registration requirements foreign broker-dealers that engage in securities transactions with certain non-U.S. persons, or with specified U.S. institutional investors under limited conditions.

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[1] Section 3(a)(4) of the Exchange Act defines "broker" as "any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank." 15 U.S.C. 78c(a)(4). The term "bank," however, is limited by section 3(a)(6) of the Exchange Act, 15 U.S.C. 78c(a)(6), to banks directly regulated by U.S. state or federal bank regulators, *see United States v. Weisscredit Banca Commerciale E D'Investimenti*, 325 F. Supp. 1384 (S.D.N.Y. 1971) (section 3(a)(6) includes only domestic institutions for purposes of Regulation T), and thus foreign banks that act as brokers or dealers within the jurisdiction of the United States, are subject to U.S. broker-dealer registration requirements. *See* letter from Michael Saperstein, Assistant Chief Counsel, Division of Market Regulation, SEC, to Edward Labaton, Sheib, Shatzkin & Cooper (July 29, 1971).

[2] Section 3(a)(5) of the Exchange Act, 15 U.S.C. 78c(a)(5), defines "dealer" as: any person engaged in the business of buying and selling securities for his own account, through a broker or otherwise, but does not include a bank, or any person insofar as he buys and sells securities for his own account, either individually or in some fiduciary capacity, but not as a part of a regular business. Although by its terms this definition is broad, it has been interpreted to exclude various activities, such as buying and selling for investment, *see, e.g.*, letter from Robert L.D. Colby, Chief Counsel, Division of Market Regulation, SEC, to Elizabeth J. Tolmach, Esq., Caplin & Drysdale (Apr. 2, 1987) (United Savings Association of Texas) (no-action position on government securities dealer registration), not within the intent of the definition. In addition, the registration requirements of section 15(a) of the Exchange Act exclude from registration additional categories of persons, such as intrastate broker-dealers. *Cf.* Douglas and Bates, *Some Effects of the Securities Act Upon Investment Banking*, 1 U. of Chi. L. Rev. 283, 302 n.68 (1934); *The Federal Securities Act of 1933*, 43 Yale L.J. 171, 206 n.189 (1933) ("rule of reason" should apply to similarly broad dealer definition in section 2(12) of Securities Act of 1933 ("Securities Act"), 15 U.S.C. 77b(12)).

[3] Specifically, section 15(a)(1), 15 U.S.C. 78o(a)(1), refers to: use of the mails or any means or instrumentality of interstate commerce to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security (other than an exempted security or commercial paper, bankers' acceptances, or commercial bills) * * *.

Section 3(a)(17) defines "interstate commerce" to include "trade, commerce, transporation, or communiciation * * * between any foreign country and any State * * *." 15 U.S.C. 78c(a)(17).

[4] These entities are referred to collectively herein as foreign broker-dealers.

[5] The staff's positions regarding broker-dealer registration of foreign persons selling securities to U.S. persons similarly would apply to registration of government securities brokers or government securities dealers under section 15C of the Exchange Act, 15 U.S.C. 78o-5, and registration of municipal securities dealers under section 15B of the Exchange Act, 15 U.S.C. 78o-4.

II. Application of the Broker-Dealer Registration Requirements to Foreign Broker-Dealers

In Securities Act Release No. 4708 ("Release 4708"),[6] the Commission articulated the conditions under which a foreign underwriter of a U.S. issuer's foreign offering of securities would not be required to register as a broker-dealer under section 15(a) of the Exchange Act.[7] The Commission indicated that registration was not required if a foreign broker-dealer limited its participation in a foreign offering of U.S. securities or the foreign part of a multinational offering of such securities to: (1) Selling securities outside the United States to non-U.S. persons, and (2) participating in an underwriting syndicate in which all U.S. activities, such as sales to selling group members, stabilization, over-allotment, and group sales, were carried out for the syndicate exclusively by a managing underwriter or underwriters registered with the Commission.

Historically, the staff has followed principles derived from Release 4708 in evaluating the need for registration of entitites engaged in securities activities primarily outside the United States and involving non-U.S. investors. The staff has not required broker-dealer registration where foreign firms [8] or U.S. firms [9] sold newly-issued U.S. securities exclusively to persons other than U.S. persons outside the United States. The staff also has taken no-action positions concerning the sale of U.S. securities by foreign broker-dealers to foreign investors outside the United States, where the securities were obtained in U.S. secondary markets through a registered broker-dealer.[10]

The staff has taken a different view of securities transactions between foreign broker-dealers and U.S. investors. Traditionally, the staff has insisted upon broker-dealer registration of foreign firms dealing with U.S. investors. As the staff indicated in 1967:

> [W]hile we sometimes raise no objection if a broker-dealer, without registration, buys securities in the United States and sells them outside the jurisdiction of the United States to persons other than United States nationals[,] we would not be willing to take such a no-action position as to broker-dealer registration if a broker-dealer sells any securities, even foreign securities, to United States nationals.[11]

Most of the early staff letters required broker-dealer registration of foreign firms executing transactions for U.S. persons, without differentiating between solicited and unsolicited trades; however, the activities described in the letters generally involved solicitation of investors. Thus, where the foreign broker-dealer engaged in transactions with U.S. investors that arguably involved some form of solicitation, the staff historically has declined to give assurances that no action would be recommended if broker-dealer registration requirements were not met.[12] Activities that the staff traditionally has viewed as involving solicitation include: running investment seminars for U.S. investors, or advertising in U.S. newspapers the activities of foreign broker-dealers and their willingness to trade foreign securities; [13] publishing quotes in the United States; [14] and providing advice about foreign securities (particularly where the advice is provided in return for brokerage commissions on transactions [15] placed with the foreign broker-dealer).[16] In addition, in several instances the Commission and staff specifically have conditioned relief from broker-dealer registration requirements specifically on a firm not soliciting or effecting trades for U.S. persons, wherever located.[17]

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[6] 29 FR 9828 (July 9, 1964), codified at 17 CFR 231. This release was denominated also as Securities Exchange Act Release No. 7366. It addressed both the need for registration under the Securities Act of securities issued abroad, and registration under the Exchange Act of foreign broker-dealers participating in foreign offering of securities of U.S. issuers.

[7] Release 4708 was issued in response to a recommendation by the Presidential Task Force on Promoting Increased Foreign Investment in United States Corporate Securities and Increased Foreign Financing for United States Corporations Operating Abroad ("Task Force"). The Task Force was charged with: * * * developing programs for the increased foreign marketing of domestic securities, with particular emphasis on the securities of United States companies operating abroad, for a review of governmental and private activities adversely affecting such financing, and for an appraisal of the various barriers to such financing remaining in major foreign capital markets.

The Task Force submitted a report to the President in 1964 recommending that, among other things, the Commission publish a release setting forth its position on Securities Act registration for U.S. issuer's foreign offerings and Exchange Act registration for foreign underwriters participating in distributions of U.S. issuers' securities exclusively to nonresidents of the United States.

[8] Letter from Robert Block, Chief Counsel, Division of Treding and Markets, SEC, to Walter Freedman, Esq., Freedman, Levy, Kroll & Simonds (July 31, 1968) (New York Hanseatic Corporation); letter from Robert Block, Chief Counsel, Division of Trading and Markets, SEC, to Irving Galpeer, Esq. Jaffin, Schaeider, Kimmel & Galpeer (June 14, 1961) (Ultoomel & Assudamai Co.).

[9] *See, e.g.*, letter from Valerie S. Golden, Attorney, Divison of Market Regulation, SEC, to Peter M. Gunnar, Esq., Gunnar & Associates P.C. (July 28, 1983) (Williams Island Associates). In isolated instances, the staff also has accorded no-action treatment to U.S. entities engaged in similar activities from within the United States. *See, e.g.*, letter from Amy Natterson Kroll, Attorney, Division of Market Regulation, SEC, to Kevin McMahon, Esq., Jones, Grey & Bayley, P.S. (Aug. 1, 1986) (Barons Mortgage Association). However, as discussed *infra* pp. 24–26, the staff believes that all U.S. persons selling U.S. securities from within this country to foreigners living abroad should satisfy U.S. broker-dealer registration requirements.

[10] *See. e.g.*, letter from Francis R. Snodgrass, Associate Director, Division of Market Regulation, SEC, to M. David Hyman, Director of Legal & Compliance Department, Bear, Stearns & Co. (Jan. 7, 1976) (Bear, Sterns/Sun Hung Kai) (Bear, Stearns & Co., a registered broker-dealer, executed trades on a fully-disclosed basis on U.S. exchanges and the over-the-counter market for customers of Sun Hung Kai Securities Ltd., a Hong Kong Stock Exchange member. None of the customers for whom Bear, Stearns, & Co. carried accounts were U.S. customers); letter from Ezra Weiss, Associate Chief Counsel, Division of Trading and Markets, SEC, to Shearman & Sterling (Oct. 25, 1968) (Hill, Samuels & Co.); letter from Robert Block, Chief Counsel, Division of Trading and Markets, SEC, to Irving Galpeer, Galpeer & Cooper (May 14, 1968) (U.S. Investment Co. Ltd); letter from Thomas Rae, Assistant Director, Division of Trading and Markets, SEC, to C.W. McAlpin, President, New Providence Securities (June 30, 1957).

[11] Letter from Robert Block, Chief Counsel, Division of Trading and Markets, SEC, to Roberto Luna (Feb. 21, 1967).

[12] *See* letter from David Romanski, Attorney, Division of Market Regulation, SEC, to Hugh Seymour, Hoare & Govett, Ltd. (Sept. 28, 1973) (Hoare & Govett); *see also* letter from Michael Saperstein, Associate Director, Division of Market Regulation, SEC, to Irving Marmer, Esq. [1972–73 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,283 (Dec. 4, 1972) (Marmer) (a foreign entity distributing foreign stock quotations to U.S. subscribers and receiving buy and sell orders from the subscribers, to be executed on foreign securities exchanges, was denied a no-action position). Foreign broker-dealers that do not solicit U.S. persons either in the United States or abroad have been granted no-action positions. *See, e.g.*, letter from Edward L. Pittman, Attorney, Division of Market Regulation, SEC, to Sydney H. Mendelsohn, Esq., Finley, Kumble, Wagner, Heine, Underberg, Manley & Casey (Nov. 8, 1985) (Wood Gundy). Commissioner Loomis also expressed this position as general policy in a 1977 letter, *see* letter from Philip A. Loomis, Commissioner, SEC, to Charles D. Ellis, President, Greenwich Research Associates, (Apr. 15, 1977), and it recently was reiterated in a letter responding to a Congressional inquiry. Letter from Robert L.D. Colby, Chief Counsel, Division of Market Regulation, SEC, to Senator William Proxmire, Chairman, Committee on Banking, Housing and Urban Affairs, United States Senate (Aug. 13, 1987).

[13] Hoare & Govett letter, *supra* note 12.

[14] Marmer letter, *supra* note 12.

[15] See discussion of "soft dollar" arrangements *infra* p. 31. *See also* Securities Exchange Act Release No. 23170 (Apr. 23, 1986), 51 FR 16004 (interpretive release concerning Exchange Act section 28(e), 15 U.S.C. 78bb(e)).

[16] Letter from Eric Thompson, Attorney, Division of Market Regulation, SEC, to Richard D. Haynes, Esq., Haynes and Boone (Aug. 23, 1974) (Wood McKenzie); letter from Francis R. Snodgrass, Chief Counsel, Division of Market Regulation, SEC, to Richard D. Haynes, Esq., Haynes and Boone (Mar. 10, 1975) (Wood McKenzie).

[17] *See, e.g.*, Release 4708; Hill, Samuels letter, *supra* note 10; New York Hanseatic Corporation letter, *supra* note 8; letter from Robert Block, Chief Counsel, Division of Trading and Markets, SEC, to R. Luna (Mar. 23, 1967); Luna letter, *supra* note 11

More recently, the staff has granted several no-action requests to foreign broker-dealers interested in developing contacts with U.S. persons, generally institutions, through the medium of registered broker-dealer affiliates. Generally, these no-action letters required the registered broker-dealer to assume responsibility for all U.S. persons' accounts, including taking orders directly from the U.S. persons, holding the accounts, confirming the trades, and maintaining all books and records on transactions for the U.S. persons. In one letter, a U.K. broker-dealer provided U.S. institutional investors with research on foreign securities through its registered U.S. broker-dealer affiliate, with the research identified as having been prepared by the U.K. broker-dealer.[18] The U.S. broker-dealer was fully responsible for executing and confirming any resulting orders and for all other aspects of the U.S. person's account.

In another recent no-action letter, a registered U.S. broker-dealer affiliate of a U.S. bank holding company acted as an intermediary between a foreign broker-dealer affiliate of the bank holding company and U.S. institutional investors that received research from that foreign affiliate.[19] In the event that a U.S. institutional investor receiving the research contacted the foreign broker-dealer, a registered representative of the U.S. affiliate would participate throughout all conversations between the U.S. investor and the foreign broker-dealer. Any orders resulting from these conversations would be executed by the U.S. broker-dealer affiliate, and the U.S. broker-dealer would handle all aspects of the U.S. institutional investors' accounts.[20]

The staff also has adopted temporary no-action positions where market maker quotations collected and published by a foreign exchange are distributed in this country. In one instance, the National Association of Securities Dealers, Inc. ("NASD") and the International Stock Exchange of the United Kingdom and the Republic of Ireland, Ltd. ("ISE") (formerly The Stock Exchange, London, England) developed a pilot program linking the NASD's NASDAQ [21] and the ISE's SEAQ [22] electronic quotation systems.[23] This program provided that NASDAQ would carry SEAQ information on selected SEAQ securities, and vice vera, with the information exchanged consisting of individual market maker quotations in these securities and a listing of the market makers' names and telephone numbers. Although the staff stated that substantial arguments could be made that the foreign market makers whose quotes were displayed in the United States through the facilities of the ISE were attempting to effect transactions in securities for purposes of U.S. broker-dealer registration provisions,[24] the staff granted the NASD's and ISE's request for a temporary no-action position regarding the pilot NASD/ISE linkage program.[25]

The staff accorded a parallel temporary no-action position to the ISE regarding the dissemination of SEAQ quotation information in the United States through the ISE's own information vendor, TOPIC.[26] Similarly, the staff issued a no-action letter regarding a pilot program providing for an exchange of quotations between NASDAQ and the Singapore Stock Exchange.[27] These no-action positions were intended to facilitates U.S. availability of up-to-date information about foreign market conditions. In adopting these positions, the staff emphasized that any activities by the market makers resulting in substantial U.S. contacts or involving solicitation of U.S. investors, other than passive dissemination of the market makers' quotes by their marketplace and the execution of trades that resulted, were beyond the scope of the no-action positions.[28]

In 1986 the Commission also issued an order exempting several related foreign broker-dealers from U.S. broker-dealer registration requirements, despite the fact that the foreign broker-dealers indirectly engaged in dealer activity in the United States.[29] The foreign broker-dealers were owned by Citicorp, a U.S. bank holding company. Citicorp proposed to purchase a U.S. affiliate of the foreign broker-dealers through Citibank, its U.S. bank subsidiary. The U.S. affiliate was a registered U.S. broker-dealer and active market maker in NASDAQ. Because the Glass-Steagall Act prevented Citibank from owning a market marker,[30] the foreign broker-dealers entered into a contractual agreement with the U.S. affiliate that called for the foreign broker-dealers to provide standing orders to buy and sell the securities in which the U.S. affiliate had previously acted as a market

[18] Letter from Kerry F. Hemond, Attorney, Division of Market Regulation, SEC, to Reid L. Ashinoff, Esq., Ashinoff, Ross & Goldman (Aug. 26, 1985) (Smith New Court/Scott Goff) (a representative of the U.K. broker-dealer was employed in the United States as a registered representative of the U.S. affiliate to answer questions concerning the research. Any resulting orders were taken by the U.S. affiliate and executed on an omnibus basis with the U.K. broker-dealer. The exact nature of the U.S. institutional customers was not defined).

[19] Letter from Amy Natterson Kroll, Attorney, Division of Market Regulation, SEC, to Frank Puleo, Esq., Milbank, Tweed, Hedley & McCloy (July 28, 1987) (Chase Capital Markets US) (the exact nature of the U.S. institutional investors was not defined).

[20] Direct contacts between U.S. investors receiving research and the foreign broker-dealer would be initiated only by the U.S. investors. The foreign broker-dealer would continue to accept unsolicited orders directly from U.S. investors other than those receiving research or otherwise solicited.

[21] National Association of Securities Dealers Automated Qutations system.

[22] Stock Exchange Automated Quotations system.

[23] *See* Securities Exchange Act Release No. 23158 (Apr. 21, 1986), 51 FR 15989, in which the Commission approved a six-month pilot program for the NASD/ISE link. After being extended for brief, interim time periods, the pilot program now has been extended to October 2, 1989. Securities Exchange Act Release No. 24979 (Oct. 2, 1987), 51 FR 37664.

[24] Letter from Robert L.D. Colby, Deputy Chief Counsel, Division of Market Regulation, SEC, to Richard B. Smith, Esq., Davis, Polk & Wardwell (July 3, 1986) (NASD/ISE).

[25] *Id.*; letter from Mary Chamberlin, Chief Counsel, Division of Market Regulation, SEC, to Frank J. Wilson, General Counsel, NASD (May 7, 1986) (NASD/ISE).

[26] Letter from Robert L.D. Colby, Chief Counsel, Division of Market Regulation, SEC, to Richard B. Smith, Esq., Davis, Polk & Wardwell (Nov. 28, 1986). Both the TOPIC and the NASD/ISE no-action positions now have been extended until the end of the pilot program on October 2, 1989, as described in note 23 *supra*. Letter from Amy Natterson Kroll, Attorney, Division of Market Regulation, SEC, to Richard B. Smith, Esq., Davis, Polk & Wardwell (Dec. 23, 1987); letter from Robert L.D. Colby, Chief Counsel, Division of Market Regulation, SEC, to Frank J. Wilson, General Counsel, NASD (Feb. 17, 1988).

[27] Letter from Amy Natterson Kroll, Attorney, Division of Market Regulation, SEC, to Frank J. Wilson, General Counsel, NASD (Dec. 11, 1987) (NASD/SSE). *See also* Securities Exchange Act Release No. 25457 (Mar. 14, 1988), 53 FR 9156.

[28] *See, e.g.*, NASD/ISE letters, *supra* notes 24, 25 Although trades could occur as a result of direct contact between the foreign market makers and NASDAQ Level 2 and 3 subscribers, such subscribers are primarily registered broker-dealers The extended pilot program now has been limited to Level 3.

[29] Letter from Jonathan Katz, Secretary, SEC, to Marcia MacHarg, Esq., Debevoise & Plimpton (Aug. 13, 1986) (Vickers da Costa/Citicorp). Section 15(a)(2) of the Exchange Act, 15 U.S.C. 78o(a)(2), authorizes the Commission to exempt any broker, dealer, or class thereof, conditionally or unconditionally, from the broker-dealer registration requirements, consistent with the public interest and the protection of investors.

[30] The Glass-Steagall Act prohibits a bank from dealing in most corporate securities, and limits a bank's non-dealer securities activities to selling securities "without recourse, solely upon the order, and for the account of, customers * * *." 12 U.S.C. 24. In addition, a bank is prohibited from associating with any entity primarily engaged in the business of "issuing, underwriting, selling or distributing * * *" securities. 12 U.S.C. 378.

maker.[31] The U.S. affiliate's activities would be limited to executing, on a riskless principal basis, any orders received from U.S. customers against these orders.[32]

In the exemption letter, the Commission allowed the foreign broker-dealers to buy and sell simultaneously on a continuing basis through the U.S. affiliate without registering in the United States as broker-dealers. However, the Commission elicited a number of representations to provide additional regulatory safeguards. The foreign broker-dealers' control over the price and size of their standing orders was limited in order to give the U.S. affiliate some discretion in its trading activities. The U.S. affiliate also agreed to satisfy additional net capital requirements intended to increase its ability to meet its settlement obligations upon failure of the foreign broker-dealers. In addition, Citicorp represented that information regarding the trading activities of the foreign broker-dealers would be made available to the Commission in connection with any investigation, and that it would attempt to obtain customer consent to release of information concerning their trading, if requested. Finally, Citicorp agreed that it would be designated as the foreign broker-dealers' agent for service of process in any proceeding or other action involving the foreign broker-dealers.[33]

III. Summary of Current Staff Interpretive Positions and Request for Comments on These Positions

The world's securities markets rapidly are becoming international in scope. Multinational offerings have become commonplace,[34] linkages are developing between trading markets,[35] and many U.S. and foreign broker-dealers are developing an international business, establishing offices throughout the world. Investor interest in trading in world financial markets has become widespread. Institutional investors, such as investment companies, pension funds, and major commercial banks, in particular, are active on an international basis.

As U.S. institutions increasingly invest in securities whose primary market is outside the United States, the ability of these institutions to obtain ready access to foreign markets has grown in importance. Foreign broker-dealers may offer valuable services to these U.S. investors. Foreign brokerdealers often provide opportunities to execute trades quickly in a wide range of foreign securities markets. Foreign brokerdealers also make available research reports concerning foreign companies, industries, and market environments that are major sources of information for U.S. institutional investors. In addition, they act as a source of market quotations on securities trading in foreign markets.

Notwithstanding the important services that may be provided by foreign broker-dealers, the Commission continues to believe that broker-dealer registration is necessary for foreign entities engaging in securities transactions directly with U.S. persons in U.S. markets. Registration of market professionals is a key element in the federal statutory scheme and plays a significant role in protecting investors. It promotes baseline levels of integrity among broker-dealers and their personnel dealing with investors, through statutory disqualification provisions and the Commission's disciplinary authority; retention of sufficient capital to operate safely, through Commission net capital requirements; and maintenance of adequate competency levels, through self-regulatory organizations ("SRO") qualification requirements. In addition, registration brings broker-dealer firms under extensive recordkeeping and reporting obligations,[36] special antifraud rules, and the Commission's broad enforcement authority over broker-dealers. That authority, in turn, helps assure that investors in the U.S. securities markets are protected by the statutory and regulatory provisions governing the U.S. securities industry.[37] Moreover, the Commission's financial supervision of all entities participating in the interdependent network of securities professionals contributes to the financial soundness of this nation's securities markets.

It is well established that, if a foreign broker-dealer forms a branch or an affiliate in the United States to provide services to U.S. persons, whether citizens or resident aliens, the U.S. branch of affiliate and its associated personnel must comply with the provisions of the Exchange Act. In particular, if the foreign broker-dealer establishes a branch, the regulatory system governing U.S. broker-dealers would apply to the entire entity. If the foreign broker-dealer establishes an affiliate, the affiliate must be registered as a broker-dealer,[38] and its personnel

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[31] Thus, the U.S. affiliate's quotes in NASDAQ always would reflect a previously entered firm order from the foreign broker-dealers.

[32] This arrangement was approved by the Comptroller of the Currency. Letter from Judith A. Walter, Senior Deputy Comptroller, to Ellis E. Bradford, Vice President, Citibank, N.A. (June 13, 1986).

[33] The foreign broker-dealers also limited their securities activities in the United States to those enumerated in the letter, and Citicorp represented that the foreign broker-dealers would not engage in any securities business with U.S. citizens.

[34] *See Internationalization of the Securities Markets*, Report of the Staff of the U.S. Securities and Exchange Commission to the Senate Committee on Banking, Housing and Urban Affairs and the House Committee on Energy and Commerce, at III-43 to III-53 (July 27, 1987) ("Report on Internationalization").

[35] Since 1985, the Commission has approved several linkages between U.S. and foreign exchanges. These include the Montreal Stock Exchange/Boston Stock Exchange link, the American Stock Exchange/Toronto Stock Exchange link, and the Midwest Stock Exchange/Toronto Stock Exchange link. *See* Report on Internationalization at V-49 to V-57, in which the linkages are discussed extensively, including their level of usage and the conditions under which they were approved.

[36] The Commission has adopted a rule that establishes requirements for U.S. maintenance of records by non-resident registered broker-dealers. 17 CFR 240.17a-7. *See also* NASD Schedules to By-Laws, Schedule C (VIII), *NASD Manual* (CCH) ¶ 1790.

[37] If the foreign broker-dealer failed to register where required, it would be subject to Commission enforcement action under section 15(a) of the Exchange Act. It also still would be subject to the Commission's broker-dealer rules, because the Exchange Act definition in section 3(a)(48) of "registered broker or dealer" includes a broker-dealer "required to register" pursuant to section 15 of the Exchange Act. 15 U.S.C. 78c(a)(48). In addition, it potentially would be exposed to customer rescission actions brought under section 29(b) of the Exchange Act, 15 U.S.C. 78cc(b). *See e.g., Regional Properties, Inc. v. Financial & Real Estate Consulting Co.*, 678 F.2d 552, 558 (5th Cir. 1982), *aff'd on other grounds*, 752 F.2d 178 (5th Cir. 1985) (later appeal); *Eastside Church of Chirst v. National Plan, Inc.*, 391 F.2d 357 (5th Cir.), *cert. denied*, 393 U.S. 913 (1968) (allowing investors to rescind transactions with an unregistered broker-dealer). *See also* Gruenbaum & Steinberg, *Section 29(b) of the Securities Exchange Act of 1934: A Viable Remedy Awakened*, 48 Geo. Wash. L. Rev. 1 (1979). Finally, the foreign broker-dealer's securities activities would continue, of course, to be subject to the antifraud provisions of the federal securities acts and the rules thereunder irrespective of the firm's lack of registration.

[38] *See supra* notes 11, 12 and accompanying text. If a U.S. issuer sells its securities in the United States using its own employees, the activities of these employees may require broker-dealer registration. *See, e.g.*, letter from Jeffrey L. Steele, Office of Chief Counsel, Division of Market Regulation, SEC, to Frank L. Hays, Hays, Patterson and Ambrose (July 14, 1977) (The Colorado Life Insurance Company). This is equally true for foreign issuers using their employees to sell securities within the United States. However, the Commission has adopted Rule 3a4-1, 17 CFR 240.3a4-1, which provides a safe-harbor from broker-dealer registration for an issuer's personnel selling the issuer's securiteis under certain circumstances. *See* Securities Exchange Act Release No. 22172 (June 27, 1985), 50 FR 27940.

whose functions are not merely clerical or ministerial must be appropriately licensed by the NASD or another SRO. Moreover, the U.S. affiliate must hold all U.S. customers' accounts and perform all functions on behalf of those accounts, including executing trades, extending credit, maintaining records and issuing confirmations, and receiving, delivering, and safeguarding funds and securities. Finally, solicitation by the foreign affiliate of U.S. persons resulting in one or more securities transactions, even where those transactions are "booked" and cleared by the U.S. affiliate, would require registration of the foreign affiliate, absent exemptive or other relief.

In some circumstances, for policy reasons, the staff believes that the Commission should not regard it as necessary for a foreign broker-dealer effecting transactions on behalf of U.S. investors to register with the Commission.[39] These circumstances, many of which previously have been the subject of staff no-action letters, are discussed below.

A. Sale of Securities to Foreign Persons

In the past, the staff has issued no-action letters indicating that a foreign entity purchasing U.S. securities through U.S. broker-dealers for resale only to foreign customers outside the United States, on a pooled or individual basis, would not be required to register as a brokerdealer.[40] In the staff's view, the use of a U.S. brokerdealer to enter the U.S. securities markets provides protection to the U.S. markets.[41] Moreover, the staff believes that, in contrast to the more expansive scope of the antifraud provisions [42] the U.S. broker-dealer registration requirements were not intended to protect foreign persons [43] dealing with foreign securities professionals outside the United States.[44] Rather, the primary responsibility for protecting foreign investors from wrongful conduct of foreign securities professionals properly lies with foreign securities regulators.

The staff's position regarding the application of the broker-dealer registration provisions to foreign broker-dealers trading with foreign customers is dependent on that trading taking place outside the United States. The staff believes that foreign persons resident in this country should receive the same broker-dealer protections as any other U.S. resident, and accordingly, the staff recommends that the Commission apply section 15(a) requirements to foreign broker-dealers trading with foreign persons in the United States.

Foreign persons domiciled abroad, but who are temporarily present in this country, pose a different question. The staff is of the view that a foreign broker-dealer that solicits or engages in securities transactions with or for such persons while they are temporarily present in this country need not register with the Commission, provided that the foreign broker-dealer had a bona fide, preexisting relationship with such persons before they entered the United States.[45] The status of a foreign national as a temporary visitor or a U.S. resident, of course, would be subject to factual analysis on a case-by-case basis.[46] Nevertheless, where the foreign investors are not merely temporary visitors, the staff believes that U.S. broker-dealer registration requirements should apply to foreign entities effecting securities transactions with them.

The staff would apply a similar standard to U.S. securities firms affecting securities transactions solely with foreign investors outside the United States. Release 4708 stated that foreign broker-dealers participating in underwriting securities of U.S. issuers exclusively outside the United States need not register in the United States as broker-dealers, but did not address the application of the broker-dealer registration provisions to entities located in the U.S. whose securities activities take place outside the United States. As noted earlier, the staff previously accorded no-action treatment to U.S. entities that sold newly-issued U.S. securities exclusively to foreign investors located outside the United States, where all sales activities were conducted outside this country.[47] While

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[39] It is important to emphasize that these conclusions turn on policy considerations and do not constitute the staff's recommendations for a Commission position on the jurisdictional limits to the extraterritorial application of U.S. broker-dealer registration requirements. As discussed previously, section 15(a) of the Exchange Act requires registration of a broker or dealer using U.S. jurisdictional means to effect transactions in securities. Given the broad definition of interstate commerce in section 3(a)(17) of the Exchange Act, *see supra* note 3, virtually any transaction-oriented contact between a foreign broker-dealer and the U.S. securities markets or a U.S. investor in the United States involves interstate commerce and could provide the jurisdictional basis for broker-dealer registration.

The extraterritorial reach of the Federal securities laws has been construed in a number of decisions concerning transnational securities fraud. *See Schoenbaum v. Firstbrook*, 405 F.2d 200, 206 (2d Cir.), *rev'd on other grounds*, 405 F.2d 215 (2d Cir. 1968) (en banc), *cert. denied sub nom. Manley v. Schoenbaum*, 395 U.S. 906 (1969) (Exchange Act could be applied extraterritorially "to protect the domestic securities market from the effects of improper foreign transactions in American securities"); *Leasco Data Processing Equipment Corp. v. Maxwell*, 468 F.2d 1326 (2d Cir. 1972) (evidence of significant conduct in the United States in relation to a foreign securities transaction would be sufficient to establish subject-matter jurisdiction) *See also Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974 (2d Cir. 1975), *modifying* 389 F. Supp. 446 (S.D.N.Y. 1974), *cert. denied sub nom. Bersch v. Arthur Andersen & Co.*, 423 U.S. 1018 (1975), and *IIT v. Vencap, Ltd.*, 519 F.2d 1001 (2d Cir.); *on remand*, 411 F. Sup. 1094 (S.D.N.Y. 1975).

Section 30(b) of the Exchange Act, 15 U.S.C. 78dd(b), excludes from the application of the Exchange Act or the rules thereunder "any person insofar as he transacts a business in securities without the jurisdiction of the United States," in the absence of Commission rules explicitly applying these provisions to such persons. While no rules have been adopted, the exemption provided by section 30(b) has been held unavailable where transactions occur in a U.S. securities market. *Roth v. Fund of Funds, Ltd.*, 405 F.2d 421 (2d Cir. 1968), *cert. denied*, 394 U.S. 975, *reh. denied*, 395 U.S. 941 (1969); *Schoenbaum*, 405 F.2d at 208; *Selzer v. The Bank of Bermuda, Ltd.*, 385 F. Supp. 415 (S.D.N.Y 1974); *In the Matter of I.O.S., Ltd. (S.A.)*, [1971–72 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,638 (Mar. 14, 1972); where offers and sales are made abroad to U.S. persons or in the United States to facilitate sales of securities abroad. *S.E.C. v. United Financial Group, Inc.*, 474 F.2d 354 (9th Cir. 1973); *Travis v. Anthes Imperial Ltd.*, 473 F.2d 515 (8th Cir. 1973); *Leasco*, 468 F.2d at 1336 n.6; *Bersch*, 389 F. Supp. at 453–459; or where the United States is used as a base for securities fraud perpetrated on foreigners. *Arthur Lipper Corp. v. S.E.C.*, 547 F.2d 171 (2d Cir. 1976), *reh. denied*, 551 F.2d 915 (2d Cir. 1977), *cert. denied*, 434 U.S. 1009 (1978).

[40] *See supra* note 10.

[41] The foreign broker-dealers can execute trades for foreign investors through U.S. broker-dealers on either an omnibus or a fully-disclosed basis. Although the staff has taken no-action positions only in the context of a fully-disclosed clearing arrangement between the foreign and U.S. broker-dealer (*e.g.*, Bear, Stearns/Sun Hung Kai letter, *Supra* note 10), the staff believes that either clearing arrangement provides adequate protection of the U.S. markets and of the Commission's ability to investigate possible violations of the U.S. securities laws from abroad.

[42] *E.g.*, Exchange Act section 10(b), 15 U.S.C. 78j(b), and Rule 10b-5 thereunder, 17 CFR 240.10b-5.

[43] If a foreign broker-dealer affiliate or subsidiary of a U.S. institution is organized or incorporated and operating outside the United States and engages only in transactions with foreign entities in foreign securities markets, the staff would not regard these foreign subsidiaries or affiliates as U.S. persons for purposes of broker-dealer registration.

[44] The staff continues to believe that the antifraud provisions of the federal securities laws should be interpreted broadly to restrain fraud involving U.S. jurisdiction means.

[45] This view is consistent with the proposal of the American Law Institute that a non-resident broker-dealer that "does business with * * * a non-national of the United States who is present as a nonresident within the United States and was previously a customer or client" should not be subject to U.S. broker-dealer jurisdiction. *All Federal Securities Code* section 1905(b)(2)(B)(1980). Professor Loss, the reporter for the Code, uses the example of a "Canadian broker who uses the telephone to service a customer who is vacationing in Florida." *Id.* at comment 9.

[46] Apart from concerns about broker-dealer registration, foreign broker-dealers should be careful that any offers or sales of securities made within the United States comply with the registration provisions of the Securities Act. *See* Securities Act Release No. 6779 (June 10, 1988).

[47] *E.g.*, Williams Island Associates letter, *supra* note 9.

the staff believes that U.S. securities firms selling such securities to foreign customers who are exclusively outside the United States should not be subject to U.S. registration requirements, where the sales, or related activities, emanate from within the United States, the staff recommends that the Commission require the firms to comply with U.S. broker-dealer registration requirements.[48] Although the protection of foreign investors is not a primary purpose of the U.S. securities laws, the staff believes that the Commission has a strong interest in regulating the conduct of securities professionals within the territorial boundaries of the United States. The staff is of the view that requiring broker-dealer registration of all persons effecting securities transactions from within the United States is consistent with the Commission's mandate under the federal securities laws and also comports with the legitimate expectations of foreign investors that persons selling securities from within this country are fully subject to the regulatory protections applicable to registered broker-dealers.[49]

B. Solicitation of U.S. Investors

The staff believes that broker-dealer registration should not be necessary if a foreign broker-dealer operating from outside the United States effects transactions for U.S. customers *only* on the customers' order, without solicitation in any form on the part of the broker-dealer. As discussed earlier, the staff generally has held that if a transaction with a U.S. customer is solicited, the broker-dealer effecting the transaction must be registered.[50] Although broker-dealer registration is an important safeguard for U.S. investors and securities markets, the staff would not apply these registration requirements where U.S. investors have sought out foreign broker-dealers outside the United States and initiated transactions in foreign securities markets entirely of their own accord. In this instance, U.S. investors would have taken the initiative to trade outside the United States foreign broker-dealers that are not conducting activities within the United States. Consequently, the U.S. investors have little reason to expect these foreign broker-dealers to be subject to U.S. broker-dealer requirements. Moreover, requiring the foreign broker-dealer to register as a broker-dealer in the United States because of unsolicited trades with U.S. persons would likely cause it to refuse to deal with U.S. persons under any circumstances. However, where a foreign broker-dealer actively solicits investors in the United States, even U.S. investors for which it previously had executed unsolicited trades, the staff believes that the foreign broker-dealer should be subject fully to U.S. broker-dealer registration requirements.[51]

The staff believes that the same position should not apply with respect to foreign broker-dealers that solicit U.S. persons resident abroad. Most U.S. persons residing abroad typically would not expect, in choosing to deal with foreign broker-dealers, that these foreign broker-dealers would be subject to U.S. registration requirements. Nor would foreign broker-dealers soliciting U.S. persons resident abroad expect that they would be covered by U.S. broker-dealer requirements. Therefore, the staff generally would not require foreign broker-dealers to register with the Commission merely because their customers include U.S. persons resident abroad. However, the Commission historically has taken the view that foreign broker-dealers that specifically target identifiable groups of U.S. persons resident abroad, *e.g.*, U.S. military and embassy personnel, could be subject to broker-dealer registration.[52] The staff is not proposing that the Commission alter this position.

As a general matter, the staff views "solicitation," in the context of broker-dealer regulation,[53] as including any affirmative effort by a broker or dealer intended to induce transactional business for the broker-dealer or its affiliates.[54] Solicitation includes efforts to induce a single transaction or to develop an ongoing securities business relationship. Conduct deemed by the staff to be solicitation includes telephone calls from a broker-dealer to a customer encouraging use of the broker-dealer to effect transactions, as well as advertising one's function as a broker or a market maker in newspapers or periodicals of general circulation in the United States, or on any radio or television station broadcasting into the United States. Similarly, the staff believes that conducting investment seminars for U.S. investors, whether or not the seminars are hosted by a registered U.S. broker-dealer, would constitute solicitation.[55] A broker-dealer also would solicit customers by, among other things, recommending the purchase or sale of particular securities, with the expectation that the customer will execute the recommended trade through the broker-dealer.

The staff believes that the provision of research to investors also may constitute solicitation by a broker or dealer. Broker-dealers often provide research to customers on a non-fee 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 impress upon customers their knowledge of specific companies or markets so that these cutomers will be encouraged to use their execution service for that company or those markets. In each instance, the basic purpose of providing the non-fee research is to generate transactional business for the broker-dealer.

The staff believes that the deliberate transmission of information, opinions, or recommendations to particular investors in the United States, whether directed at individuals or groups, could result in the conclusion that the foreign broker-dealer

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[48] In several instances, the staff has accorded no-action treatment where such sales activities were conducted in part from within this country. Barons Mortgage Association letter, *supra* note 9; letter from Lynne G. Masters, Attorney, Office of Chief Counsel, Division of Market Regulation, SEC, to Chester J. Jachimiec, Esq., Winstead, McGuire, Sechrest & Minick (Aug. 3, 1987) (States Petroleum, Inc.). To the extent that these letters are inconsistent with the position recommended by the staff in this release, they would be so modified upon the Commission's adoption of this position.

[49] This position is consistent with that adopted by the staff of the Division of Investment Management concerning investment advisers. *see* letter from Joseph R. Fleming, Attorney, Division of Investment Management, to Gim-Seong Seow (Oct. 30, 1987).

[50] *see supra* pp. 7–9; *see also* Report on Internationalization at V–42.

[51] In this regard, the Commission's position is consistent with that taken by foreign securities regulators. *see* Financial Services act 1986, section 1(3)(b); Schedule 1, Part IV, section 26, 27 (United Kingdom).

[52] *See* Release 4708 (a public offering of securities specifically directed toward U.S. citizens abroad, such as military personnel, would be regarded as subject to securities, Act registration); *S.E.C. v. Siamerican Securities, Ltd.*, Litigation Release No. 6937 (June 17, 1975) (charging section 15(a) violation, among other things, regarding solicitation of securities transactions from American citizens stationed in Southeast Asia, for execution primarily on U.S. exchanges and over-the-counter markets).

[53] Section 15(a) of the Exchange Act requires registration of brokers and dealers that "induce *or attempt to induce* the purchase or sale of, any security." 15 U.S.C. 78o(a) (emphasis added). If a foreign broker-dealer effected trades using the U.S. jurisdictional means so as to fall within section 3(a)(4) or (5)'s definitions of broker or dealer, solicitation of trades from U.S. customers would be sufficient to trigger section 15(a)'s registration requirements.

[54] The Report on Internationalization said: key to the issue of solicitation is whether the foreign broker-dealer's contacts with U.S. markets reasonably may be viewed as attempting to induce an investor's purchase or sale of a security.

Report on Internationalization at V–42; *see also* Hoare & Govett letter, *supra* note 12.

[55] *See* Hoare & Govett letter, *supra* note 12.

has solicited those investors.[56] The staff, however, would not consider the foreign broker-dealer to have solicited trades by U.S. investors through providing research unless the foreign broker-dealer directed the research to U.S. investors and knew or reasonably could have determined that its research would generate trades by those investors. In this regard, it is the foreign broker-dealer's obligation to develop adequate procedures to avoid transmission of research reports into U.S. markets that may be expected to induce transactions in securities by U.S. persons. Alternatively, if foreign broker-dealers choose to provide research to U.S. investors that is expected to induce transactions, these foreign broker-dealers should review their compliance procedures to ensure that these procedures will prevent trades from being effected in securities identified in the research, in order to avoid violating the U.S. broker-dealer registration requirements.

In many cases, research is provided to customers with the express or implied understanding that the customer will pay for it in commission dollars by directing trades to the broker-dealer.[57] These "soft dollar" research arrangements are used widely by broker-dealers both in the United States and abroad. Where foreign broker-dealers provide research to U.S. investors pursuant to express or implied understandings that the investor will direct a given amount of commission income to the foreign broker-dealer, the staff would consider the foreign broker-dealer to have induced purchases and sales of securities, irrespective of whether the trades received from the investor related to particular research that has been provided.

The staff does not wish to restrict U.S. investors' ability to obtain research of foreign origin where adequate regulatory safeguards are present. Therefore, consistent with the staff no-action positions discussed earlier, the staff would not consider research reports prepared by a foreign broker-dealer to constitute solicitation by the foreign broker-dealer of an order from a U.S. investor, where the research reports are distributed to U.S. investors by an affiliated U.S. broker-dealer, that affiliated broker-dealer prominently states in writing on the research report that it has accepted responsibility for the content of the research,[58] the research report prominently indicates that any U.S. persons receiving the research and wishing to effect transactions in any security discussed should do so with the U.S. affiliate, not the foreign broker-dealer, and transactions with U.S. investors in any securities identified in the research actually are effected only with or through the U.S. affiliate, not the foreign broker-dealer.

It is important to note that the responsibility to register as a broker-dealer, once incurred, is a continuing obligation. If a foreign broker-dealer solicits investors in the United States and executes securities transactions for those investors, the staff believes that the foreign broker-dealer has an obligation to register with the Commission as a broker-dealer. This obligation continues until the foreign broker-dealer completely ceases to do business with or for those investors. Even if a foreign broker-dealer, after incurring this obligation, limited its trading with investors in the United States to execution of unsolicited trades, its activity would require the foreign broker-dealer to comply with the U.S. broker-dealer registration requirements.

C. Exchange of Quotations

The dissemination in the United States of a broker-dealer's quotes for a security typically would be a form of solicitation. Nonetheless, the staff has given assurances that no enforcement action would be recommended for lack of broker-dealer registration with respect to the collective distribution by organized foreign exchanges of foreign market maker quotes, primarily to registered U.S. broker-dealers.[59] While the staff supports this position, it is important to note that the individual dissemination of a market maker's quotations to U.S. investors, such as through a private quote system, is not covered by the NASD/ISE, TOPIC, or NASD/SSE no-action positions. Finally, as the no-action letters indicate, other contacts with U.S. investors on the part of market makers whose quotations are disseminated by the foreign markets, viewed together with the market's dissemination of these quotations, might result in the conclusion that the market makers have solicited U.S. investors and would be required to register as broker-dealers if trades are effected for those investors.[60]

D. Use of U.S. Broker-Dealer Affiliates

Many foreign broker-dealers have established registered broker-dealer affiliates in the United States that are fully qualified to deal with U.S. investors and trade in U.S. securities.[61] Nonetheless, these foreign broker-dealers may prefer to deal with major U.S. institutional investors from their overseas trading desks, where their dealer operations are based. In addition, because overseas trading desks often are principal sources of current information on foreign market conditions and foreign securities, many U.S. institutional investors want direct contact with these traders. However, foreign broker-dealers are not themselves willing to register as U.S. broker-dealers, because registration would require the entire firm to comply with U.S. broker-dealer requirements.

The no-action request granted to Chase Capital Markets US, discussed earlier, provided a means for foreign trading operations to communicate with U.S. institutional investors without the foreign broker-dealers registering in the United States. Under the terms of that letter, the foreign broker-dealer may communicate with U.S. institutional investors through the U.S. affiliate, with a U.S.-qualified representative participating in telephone conversations, effecting transactions, and taking full responsibility for the trades. Like the Vickers da Costa/Citicorp exemption letter,[62] the letter to Chase Capital Markets US provided that the foreign broker-dealer would assist the Commission in the conduct of

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[56] If a branch or affiliate of a foreign entity in the United States disseminates research information, registration as an investment adviser may also be required. *See* section 203 of the Investment Advisers Act of 1940, 15 U.S.C. 80b–3.

[57] *See* Wood McKenzie letters, *supra* note 16.

[58] Article III, section 35(d)(2) of the NASD Rules of Fair Practice requires that all "[a]dvertisements and sales literature shall contain the name of the [NASD] member, [and of] the person or firm preparing the material, if other than the member" and that "[s]tatistical tables, charts, graphs or other illustrations used by members * * * should disclose the source of the information if not prepared by the member." *NASD Manual* (CCH) ¶ 2195 at 2177–78. Under section 35(a)(1), "advertisement" means any "material published, or designed for use in" various public print and electronic media. *Id.* at 2174. Under section 35(a)(2), "sales literature" specifically includes "research reports, market letters, performance reports or summaries, [and] seminar tests * * *." *Id.* Rule 472.40(7) of the New York Stock Exchange requires that communications with the public that are "not prepared under the direct supervision of the [NYSE] member organization or its correspondent [NYSE] member organization should show the person (by name and appropriate title) or outside organization which prepared the material." *NYSE Guide* (CCH) ¶ 2472.40(7) at 4027. Under Rule 472.10(a), a "[c]ommunication" includes "market letters [and] research reports * * *." *Id.* at ¶ 2472.10(1). The staff proposes that the Commission not view compliance with these requirements, in itself, as solicitation by the foreign affiliate.

[59] *See* NASD/ISE, TOPIC, and NASD/SSE letters *supra* notes 24, 25, 26, and 27.

[60] *See supra* p. 13.

[61] *See, e.g.*, Chase Capital Markets US letter, *supra* note 19.

[62] *Supra* note 29.

investigations by furnishing information concerning its contacts with U.S. investors and trading records relating to the execution of U.S. investors' orders by the firm. Both letters also indicated that the foreign broker-dealers would endeavor, directly or indirectly, to obtain the consent of foreign customers to the release of any information sought by the Commission.

The staff supports the concept of allowing foreign broker-dealers to solicit transactions with U.S. institutional investors through U.S. registered broker-dealer affiliates. Accordingly, the staff will continue to consider granting appropriate relief permitting foreign broker-dealers to be in contact with U.S. institutional investors without registration, provided that a U.S. broker-dealer affiliate is fully responsible both for these contacts and for executing any solicited trades from the U.S. investors,[63] including confirming, clearing, and settling the trade, safekeeping customers' funds and securities, maintaining records of the trade, making appropriate net capital computations regarding the trade, and arranging for extending any credit used to purchase securities.[64] In addition, the foreign broker-dealer must agree to provide records and information concerning its contacts with U.S. institutional investors and its execution of their orders, when requested by the Commission. Further, the foreign broker-dealer must provide the Commission with assistance in obtaining information and evidence from other persons related to the transactions, including obtaining the consent of its foreign customers to the release of information sought by the Commission, and must consent itself to service of process upon the U.S. affiliate as its agent.[65] Finally, the staff recommends that the Commission not object if the registered representatives of the U.S. broker-dealer affiliate participating in contacts between the foreign broker-dealer and U.S. investors also are employees of the foreign broker-dealer. Assuming that the U.S. broker-dealer maintained the required supervision and control of these employees and the arrangement satisfied the above conditions, the employees could be located in the foreign broker-dealer's overseas offices.

E. Request for Comments on Staff Interpretations

Sections II and III of this release review staff interpretive and no-action positions regarding foreign broker-dealer registration, and articulate current staff views incorporating these past positions. These positions have been developed over more than three decades, primarily in no-action letters provided by the staff to the securities bar. The Commission preliminarily concurs in these staff positions and believes that publication of a comprehensive discussion of current positions provides valuable assistance to foreign broker-dealers and their counsel in determining their registration obligations. The Commission believes that it is appropriate to provide the public an opportunity to comment on these positions before the Commission adopts some or all of them as its own. Comments are invited on all aspects of the staff positions expressed in this release, including whether they provide adequate protection to U.S. markets and investors, and whether reliance upon them would be practicable under current market conditions.

The development of comprehensive regulatory schemes for broker-dealers in other countries suggests the possibility that in the future some form of reciprocal recognition for broker-dealers could be agreed upon with foreign securities regulators. Under a reciprocal recognition approach, each participating country would recognize regulation of securities professionals in a foreign jurisdiction as a substitute in some degree for its own domestic broker-dealer regulation.[66] Recognition of foreign broker-dealer regulatory schemes on a reciprocal basis potentially could facilitate cross-border operations for international broker-dealers. But reciprocal recognition could raise the possibility of reduced U.S. investor protection, unless the foreign jurisdiction had a broker-dealer regulatory system that was comparable and compatible with that of the United States, this system was consistently and comprehensively enforced, and ready cooperation in surveillance and enforcement matters between the United States and the foreign jurisdiction was the norm. In view of these considerations, the Commission is weighing whether some form of reciprocal recognition for international broker-dealers could be developed at some future point.

IV. Proposed Rule 15a-6

Although the Chase Capital Markets US letter establishes a reasonable means by which foreign broker-dealers may maintain relationships with U.S. institutional investors without registering in the United States, the Commission is concerned that certain of the conditions incorporated into that letter may prove to be cumbersome in some circumstances for foreign broker-dealers seeking to provide research and analysis to major institutional investors. Accordingly, the Commission is proposing a rule under section 15(a)(2) of the Exchange Act [67] that would

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[63] Of course, as discussed earlier, *see supra* note 17 and accompanying text, if a transaction is demonstrably unsolicited, execution of the trade through the U.S. affiliate would be unnecessary. *But see* discussion *supra* p. 31 regarding soft-dollar arrangements.

[64] The U.S. registered broker-dealer would be free to execute the trade with the foreign firm's overseas trading operation.

[65] The staff is aware that, through blocking and secrecy statutes, certain countries limit the ability of local entities to release information. The Commission and several foreign governments and regulators have entered into agreements in an attempt to overcome the limits imposed by these statutes. Treaties for Mutual Assistance in Criminal Matters have been concluded with Switzerland, Turkey, Canada, Italy, and the Netherlands. A Memorandum of Understanding with respect to problems of insider trading has been entered into with Switzerland. In addition, a Memorandum of Understanding on Matters Relating to Securities has been entered into with the United Kingdom Department of Trade and Industry. Also, the Commission and the Japanese Ministry of Finance's Securities Bureau have signed a memorandum concerning the exchange of information in the area of securities regulation. Recently, the Commission signed a Memorandum of Understanding ("Canadian MOU") with the Ontario Securities Commission, the Commission des Valeurs Mobilieres du Quebec, and the British Columbia Securities Commission concerning mutual cooperation in matters relating to the administration and enforcement of U.S. and Canadian securities laws. The mutual assistance contemplated by the Canadian MOU includes providing access to information in the files of each securities authority and obtaining compulsory depositions and production of documents. The Canadian MOU recognizes that a signatory may not have the authority to provide such assistance, but the signatories undertake to seek to obtain that authorization if necessary.

The staff expects that these agreements will allow access to trading and other records that the Commission requires in order to carry out its mandate of investor protection. Ultimately, the staff hopes that reciprocal statutory provisions providing for information-sharing will exist between all countries in which securities markets operate. Such information-sharing provisions would ensure, among other things, access to trading records and other information requested by representatives of any country maintaining a reciprocity statute. The Commission is willing and able to enter into additional and more comprehensive MOUs, but at present, foreign broker-dealers in all countries, including those with no such agreements, bear the responsibility for providing foreign customer information to the Commission at its request.

[66] The Commodity Futures Trading Commission ("CFTC") recently adopted a unilateral recognition approach for regulation of certain foreign futures commission merchants. The CFTC provided an exemption from its rules governing the sale of options and futures traded on a foreign board of trade by futures commission merchants located outside the United States, if these futures commission merchants demonstrated that they were subject to a regulatory scheme comparable to that of the CFTC. 52 FR 28980.

[67] 15 U.S.C. 78o(a)(2).

provide an exemption from broker-dealer registration for foreign broker-dealers that effect trades for major U.S. institutional investors through a U.S. registered broker-dealer affiliate, or that limit their activities entirely to certain non-U.S. persons. Although based upon the approach set forth in the Chase Capital Markets US letter, the rule is broader in certain respects.

A. Foreign Broker-Dealer Transactions with U.S. Institutional Investors

Unlike the Chase Capital Markets US letter, proposed Rule 15a–6 would allow foreign broker-dealers to contact certain classes of U.S. institutional investors, as defined in the rule, without the participation of an employee of a U.S. broker-dealer affiliate. However, the rule would require the foreign broker-dealer's personnel involved in the transactions to meet certain requirements, and the U.S. broker-dealer affiliate to be responsible for supervising the contact and any resulting trades. If a trade is agreed upon, the rule would require the U.S. broker-dealer affiliate to execute the trade on behalf of the investor, taking full responsibility for all aspects of the trade. In addition, the rule would expand the activities of foreign broker-dealers by allowing them to initiate contact with specified U.S. persons, if all such contacts are conducted in compliance with the provisions of the rule.

In general, proposed Rule 15a–6(a) would exempt from the broker-dealer registration requirement of section 15(a) foreign brokers or dealers that induce or attempt to induce the purchase or sale of any security by U.S. institutional investors under conditions enumerated in the rule. Among the conditions is a requirement in paragraph (a)(1)(iv) of the rule that the foreign broker-dealer must conduct its activities through a registered U.S. broker-dealer affiliate.[68] Further, under paragraphs (a)(1) (ii) and (iii) of the rule, the availability of the safe harbor is conditioned on foreign associated persons of the foreign broker-dealer not being subject to a statutory disqualification specified in section 3(a)(39) of the Exchange Act [69], or violations of substantially equivalent foreign statutes or regulations, and conducting their securities activities exclusively from without the United States.

The U.S. broker-dealer affiliate would not be required to be a party to all communications with the specified U.S. institutional investors. However, paragraph (a)(1)(iv)(A)(*1*) of the rule would require the U.S. affiliate to obtain and keep a record of the information required by Rule 17a–3(a)(12) [70] with respect to each individual associated with the foreign broker-dealer who will be in contact with U.S. institutional investors. This requirement is intended to ensure that the U.S. broker-dealer will receive notice of the identity of, and has reviewed the background of, foreign personnel who will contact U.S. institutional investors. It also would provide the Commission with ready access to information concerning these persons. The Commission solicits comment whether this method would be suitable for obtaining information concerning foreign persons, or whether use of Form U–4 or a Commission-designed form would be more appropriate. The Commission also requests comment on whether further information should be required and whether the U.S. affiliate would experience any difficulties in obtaining the required information from foreign broker-dealers or their personnel.

In addition, under paragraph (a)(1)(iv)(A)(*2*) of the rule, the U.S. broker-dealer would have to obtain written consents, from the foreign broker-dealer and each foreign individual in contact with U.S. institutional investors, to service of process for any civil action or proceeding conducted by the Commission or an SRO. Written records of these assurances and consents would have to be maintained in the United States by the U.S. broker-dealer affiliate.

Furthermore, paragraph (a)(1)(iv)(B) of the rule would require the registered U.S. broker-dealer affiliate effecting the trades to be responsible for all aspects of the U.S. institutional investor's account, including: Extensions of or arrangements for extensions of credit in connection with securities transactions; maintenance of applicable books and records, including those required by Rules 17a–3 and 17a–4; [71] receipt, delivery, and safeguarding of funds and securities in compliance with Rule 15c3–3; [72] and confirmations and statements. Under paragraph (a)(1)(iv)(A)(*3*) of the rule, the registered broker-dealer also would have to maintain all records in connection with trading activities of the U.S. institutional investors, as well as the records required under paragraphs (a)(1)(iv)(A) (*1*) and (*2*) of the rule, and make the records available to the Commission upon request. In addition, paragraph (a)(1)(v) of the rule would require that the foreign broker-dealer provide the Commission with any information, documents, or records in its possession, custody, or control, the testimony of any of its foreign associated persons, and assistance in taking the evidence of other persons that relate, directly or indirectly, to transactions with a U.S. institutional investor or with the U.S. broker-dealer that executes them.

Foreign broker-dealers that did not comply with these requirements would

[68] The Commission requests comment whether the nature of such affiliation should involve a specified degree of ownership or control.

[69] Section 3(a)(39) of the Exchange Act, 15 U.S.C. 78c(a)(39), speaks of statutory disqualifications with respect to membership or participation in, or association with a member of, an SRO. Proposed Rule 15a–6 thus uses the definition for purposes beyond SRO membership, *i.e.*, by serving to prevent contact between certain foreign associated persons and U.S. institutional investors.

[70] 17 CFR 240.17a–3 requires every member of a national securities exchange that transacts securities business directly with non-members, every worker or dealer that transacts securities business through any such member, and every broker or dealer registered under section 15 of the Exchange Act to make and keep current certain books and records. Paragraph (a)(12)(i) requires every broker or dealer that transacts securities dealer to execute a questionnaire or application for employment containing at least the following information: (a) Name, address, social security number, and starting date of association; (b) date of birth; (c) a complete, consecutive statement of all business connections for at least the preceding ten years, whether part-time or full time; (d) a record of any denial of membership or registration, and of any disciplinary action taken or sanction imposed by any state or Federal agency, or by any national securities exchange or national securities association, including any finding that the associated person was a cause of any disciplinary action or had violated any law; (e) a record of any denial, suspension, expulsion, or revocation of membership or registration of any member or broker-dealer with which the associated person was connected in any way when such action was taken; (f) a record of any permanent or temporary injunction was entered against the associated person or any member or broker-dealer with which the associated person was connected in any way when such an injunction was entered; (g) a record of any arrest or indictment for any felony, or any misdemeanor pertaining to securities, commodities, banking, insurance, or real estate (including, without limitation, acting as or being associated with a broker-dealer, investment company, investment adviser, futures sponsor, bank, or savings and loan association), fraud, false statements or omissions, wrongful taking of property, bribery, forgery, counterfeiting, or extortion, and the disposition of any of these; and (h) a record of any other name or names by which the associated person has been known or which the associated person has used. Paragraph (a)(ii) defines "associated person" as any partner, officer, director, salesman, trader, manager, or any employee handling funds or securities or soliciting transactions or accounts for such member or broker-dealer. Only one modification would be required in the information described in paragraph (a)(12)(i)(d). Specifically, the foreign broker-dealer must include sanctions imposed by both domestic and foreign securities authorities, exchanges, or associations. The other categories of information required already are broad enough to include foreign activity.

[71] 17 CFR 240.17a–3 and 240.17a–4.

[72] 17 CFR 240.15c3.3.

not be able to rely upon the proposed safe harbor from broker-dealer registration. Accordingly, the Commission requests comment whether foreign broker-dealers would experience any difficulties in meeting these requirements, including assisting the Commission in taking evidence of foreign persons, and whether registered U.S. broker-dealers would experience any difficulty in maintaining the records required by the rule.

Moreover, because of its supervisory responsibility for the U.S. institutional investor's account and because of its affiliate relationship with the foreign broker-dealer, the U.S. affiliate will be responsible for taking reasonable steps to assure itself that any such transactions are not effected in a manner inconsistent with U.S. securities laws. In this regard, the U.S. affiliate also would be responsible for taking reasonable steps to assure itself, for example, that there is a reasonable basis for any recommendation made by the foreign affiliate or its personnel.

The exemption provided in paragraph (a)(1) would be available to foreign broker-dealers that satisfy the foregoing structural requirements, and limit their activities involving U.S. persons to certain large institutional investors. For purposes of the rule, a U.S. institutional investor is defined under paragraph (b)(2)(ii) to include: (1) An entity established under U.S. or state law; (2) an entity established under foreign law, if the entity's business is conducted principally in the United States; and (3) a branch of a foreign entity located in the United States. Within the broad category of such institutions, paragraph (b)(2)(i) further limits the term "U.S. institutional investor" to U.S. persons that are described in Rule 501(a) (1), (2), or (3) of Regulation D under the Securities Act,[73] and that, with the exception of registered broker-dealers, have total assets in excess of $100 million. These investors include banks (but not U.S. branches of foreign banks), savings and loan associations, brokers or dealers registered under section 15(b) of the Exchange Act, insurance companies, registered investment companies, small business investment companies, employee benefit plans, private business development companies, and certain section 501(c)(3) organizations under the Internal Revenue Code. While not treated as accredited investors under Regulation D,[74] registered investment advisers are included as U.S. institutional investors within the rule if they have $100 million in assets under management. Further, if a registered investment company itself does not have total assets in excess of $100 million, it still may qualify as a U.S. institutional investor if it is part of a family of investment companies that has total assets in excess of $100 million. Paragraph (b)(4) of the rule defines "family of investment companies," with special treatment of insurance company separate accounts.

The proposed asset limitation in the rule is based on the assumption that direct U.S. oversight of the competence and conduct of foreign sales personnel may be of less significance where they are soliciting only U.S. institutional investor with high levels of assets. The $100 million asset level, derived from the reporting standard of section 13(f) of the Exchange Act,[75] is designed to increase the likelihood that the institution or its investment advisers have prior experience in foreign markets that provides insight into the reliability and reputation of various foreign broker-dealers. The Commission seeks comment on whether the proposed asset test used in the definition of U.S. institutional investor is adequate and appropriate to achieve the Commission's purposes. The Commission also requests comment on whether other factors, including distinguishing among types of institutions for purposes of establishing minimum asset levels, should be considered.

"Foreign broker or dealer" is defined in paragraph (b)(1) as any foreign entity (including a foreign bank) whose activities, if conducted in the United States, would bring it within the definition of "broker" [76] or "dealer" [77] under the Exchange Act. However, an overseas office or branch of a U.S. registered broker or dealer would not be a foreign broker or dealer. Finally, paragraph (b)(3) defines "foreign associated person" as any natural person who is an associated person, within the meaning of section 3(a)(18) of the Exchange Act,[78] of a foreign broker or dealer and who participates in solicitation of a U.S. institutional investor. The Commission requests comment on these definitions.

B. Foreign Broker-Dealer Transactions Limited Solely to Non-U.S. Persons

As discussed earlier, foreign broker-dealers that do not contact U.S. persons need not register with the Commission. Under paragraph (a)(2) of the rule, foreign broker-dealers that limit their activities to certain persons would be exempt from broker-dealer registration without being required to comply with the requirements of paragraph (a)(1). These persons include: (1) A bona fide agency or branch of a U.S. person located outside the United States; (2) any affiliate or subsidiary of a U.S. person located outside the United States, that is established under foreign law; and (3) certain international organizations, regardless of location.[79]

V. Conclusion

In publishing this release, the Commission seeks to clarify ambiguities that have arisen regarding when a foreign entity is required to register as a broker-dealer. This release sets forth for comment staff views on registration, which the Commission preliminarily supports, in preparation for publication of a Commission position on this subject. The release also proposes for comment an exemptive rule for foreign entities that deal with certain non-U.S. persons, or with specified U.S. institutional investors under certain limited conditions.[80]

The Commission anticipates that proposed Rule 15a-6, if adopted, will allow major U.S. institutional investors more efficient access to foreign broker-dealers, and through them to foreign markets, without jeopardizing the fundamental protection that the U.S. securities laws provide. The proposed rule is designed to maintain safeguards for U.S. institutional customers through the intermediation of the U.S. registered broker-dealer and the recordkeeping requirements. The responsibility of the U.S. broker-dealer for executing all trades would ensure that a record of the trading was available in the United States, which would facilitate Commission review of this trading and also subject this trading to the U.S. broker-dealer's supervisory responsibility.

Proposed Rule 15a-6 would supplement the positions expressed previously in this release, providing an alternative structure for dealing with the specified U.S. investors without being subject to the broker-dealer registration

[73] 17 CFR 230.501(a) (1), (2), or (3).

[74] 17 CFR 230.501(a).

[75] 15 U.S.C. 78m(f).

[76] *Supra* note 1.

[77] *Supra* note 2.

[78] 15 U.S.C. 78c(a)(18).

[79] It is important to note that this exemption is intended to apply to transactions with the institutions, and not with personnel of the institutions in their individual capacity.

[80] However, the Commission's views on registration of foreign broker-dealers and proposed Rule 15a-6 do not necessarily reflect the requirements of any state securities statutes, which may apply to the activities of foreign broker-dealers within the jurisdiction of such states.

provisions of section 15(a). In addition to the comments requested earlier, the Commission requests comment whether this structure provides a viable means for foreign broker-dealers to approach U.S. institutional investors without sacrificing basic broker-dealer protections; whether the safeguards provided by the U.S. broker-dealers' involvement are sufficient to allow foreign broker-dealers to solicit investors in the United States; whether the conditions included in the rule provide sufficient protection to U.S. institutional investors dealing directly with foreign broker-dealers; and whether foreign broker-dealers feasibly could institute recordkeeping and monitoring procedures to prevent effecting transactions with investors in the United States in securities promoted in research directed by the foreign broker-dealer or its U.S. affiliates to such investors.

VI. Regulatory Flexibility Act Analysis

Section 3(a) [81] of the Regulatory Flexibility Act ("RFA") requires the Commission to undertake an initial regulatory flexibility analysis of the impact of a proposed rule on small entities, unless the Chairman certifies that the rule, if adopted, would not have a significant economic impact on a substantial number of small entities.[82] The application of the RFA to proposed Rule 15a-6 is limited, because its exemptive provisions would be restricted to foreign broker-dealers, which need not be considered under RFA.[83] In addition, to the extent that the proposed rule, if adopted, would impose any costs on registered broker-dealer affiliates of such foreign broker-dealers or to have a competitive effect on other domestic broker-dealers, those costs are not significant and would not impact a substantial number of small domestic broker-dealers. Accordingly, the Chairman has certified that the proposed rule, if adopted, would not have a significant economic impact on a substantial number of small entities.

VII. Statutory Authority

Pursuant to the Securities Exchange Act of 1934 and particularly sections 3, 10, 15, 17, 23, and 30 thereof, 15 U.S.C. 78c, 78j, 78*o*, 78q, 78w, and 78dd, the Commission proposes to adopt § 240.15a-6 of Title 17 of the Code of Federal Regulations in the manner set forth below.

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[81] 5 U.S.C. 603(a).

[82] 5 U.S.C. 605(b).

[83] 5 U.S.C. 605.

VIII. Text of Proposed Rule

In accordance with the foregoing, it is proposed to amend 17 CFR Part 240 as follows:

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

1. The authority citation for Part 240 is amended by adding the following citations:

Authority: Sec. 23, 48 Stat. 901, as amended (15 U.S.C. 78w) * * * Section 240.15a-6, also issued under secs. 3, 10, 15, 17, and 30, 15 U.S.C. 78c, 78j, 78*o*, 78q, and 78dd;

2. By adding § 240.15a-6 after the undesignated heading as follows:

Registration of Brokers and Dealers

§ 240.15a-6 Exemption of certain foreign brokers or dealers.

(a) A foreign broker or dealer subject to the registration requirement of paragraph (1) of section 15(a) of the Act, because it induces or attempts to induce the purchase or sale of any security by a U.S. person, shall be exempt from paragraph (1) of section 15(a), if:

(1)(i) Such activities of the foreign broker or dealer involving U.S. persons are limited to U.S. institutional investors;

(ii) Each foreign associated person is not subject to a statutory disqualification specified in section 3(a)(39) of the Act, or a violation of any substantially equivalent foreign statute or regulation;

(iii) Each foreign associated person conducts all securities activities from outside the United States; and

(iv) The foreign broker or dealer effects such transactions with the U.S. institutional investor through a broker or dealer registered with the Commission pursuant to section 15(b) of the Act, and

(A) The registered broker or dealer:

(*1*) Obtains from the foreign broker or dealer, with respect to each foreign associated person, the information specified in Rule 17a-3(a)(12) under the Act (17 CFR 240.17a-3(a)(12)): *Provided*, That the information required by paragraph (a)(12)(d) of such Rule shall include sanctions imposed by foreign securities authorities, exchanges, or associations;

(*2*) Obtains from the foreign broker or dealer and each foreign associated person written consent to service of process for any civil action brought by or proceeding before the Commission or a self-regulatory organization (as defined in section 3(a)(26) of the Act), stating that process may be served on the registered broker or dealer as provided on the registered broker or dealer's current Form BD; and

(*3*) Maintains a written record of the information and consents required by paragraphs (a)(1)(i)(A) (*1*) and (*2*) of this section, and all records in connection with trading activities of a U.S. institutional investor involving the foreign broker or dealer conducted pursuant to paragraph (a)(1) of this section, in an office of the registered broker or dealer located in the United States, and makes such records available to the Commission upon request; and

(B) The registered broker or dealer is responsible for:

(*1*) Executing the transactions with or for the U.S. institutional investor,

(*2*) Extending or arranging for the extension of credit to the U.S. institutional investor in connection with the purchase of securities,

(*3*) Maintaining all applicable books and records, including those required by Rules 17a-3 and 17a-4 under the Act (17 CFR 240.17a-3 and 240.17a-4),

(*4*) Receiving, delivering, and safeguarding funds and securities or behalf of the U.S. institutional investor in compliance with Rule 15c3-3 under the Act (17 CFR 240.15c3-3), and

(*5*) Issuing all required confirmations and statements to the U.S. institutional investor; and

(v) The foreign broker or dealer provides the Commission, upon request or, if applicable, pursuant to agreements reached between any foreign jurisdiction or any foreign securities authority and the Commission or the U.S. Government, with any information, documents, or records within the possession, custody, or control of the foreign broker or dealer, any testimony of foreign associated persons, and any assistance in taking the evidence of other persons, wheresoever located, that the Commission requests and that directly or indirectly relates to transactions with a U.S. institutional investor or with the registered broker or dealer that executes the transactions; or,

(2) The activities of such foreign broker or dealer are limited to:

(i) Any agency or branch of a U.S. person located outside the United States, that operates for valid business reasons;

(ii) Any affiliate or subsidiary of a U.S. person, located outside the United States, that is organized or incorporated under the laws of any foreign jurisdiction; or

(iii) The International Monetary Fund, the International Bank for Reconstruction and Development, and

the United Nations and its agencies and affiliates.

(b) When used in this rule,

(1) The term "foreign broker or dealer" shall mean any non-U.S. resident entity that is neither an office nor a branch of a U.S. 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) and 3(a)(5) of the Act.

(2) The term "U.S. institutional investor" shall mean a person that is both:

(i) (A) (*1*) A broker or dealer registered with the Commission under section 15(b) of the Act;

(*2*) An investment company registered with the Commission under section 8 of the Investment Company Act of 1940, if the investment company itself, or any family of investment companies of which it is a part, has total assets in excess of $100 million; or

(*3*) Any 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; or

(B) An accredited investor as defined in 17 CFR 230.501(a) (1), (2), or (3) (not including a broker or dealer registered with the Commission under section 15(b) of the Act, or an investment company registered with the Commission under section 8 of the Investment Company Act of 1940) that has total assets in excess of $100 million; and

(ii) (A) Organized or incorporated under the laws of the United States or its territories or possessions, or any state or the District of Columbia;

(B) Organized or incorporated under the laws of any foreign jurisdiction, if its business is conducted principally in the United States; or

(C) A branch of a foreign entity, which branch is located in the United States or its territories or possessions.

(3) The term "foreign associated person" shall mean any natural person resident outside the United States who is an associated person, as defined in section 3(a)(18) of the Act, of a foreign broker or dealer and who participates in solicitation of a U.S. institutional investor.

(4) The term "family of investment companies" shall mean:

(i) Except for insurance company separate accounts, any two or more separately registered investment companies under the Investment Company Act of 1940 that share the same investment adviser or principal underwriter and hold themselves out to investors as related companies for purposes of investment and investor services; and

(ii) With respect to insurance company separate accounts, any two or more separately registered separate accounts under the Investment Company Act of 1940 that share the same investment adviser or principal underwriter and function under operational or accounting or control systems that are substantially similar.

By the Commission.

Jonathan G. Katz,

Secretary.

June 14, 1988.

Regulatory Flexibility Act Certification

I, David S. Ruder, Chairman of the Securities and Exchange Commission, hereby certify pursuant to 5 U.S.C. 605(b) that proposed Rule 15a-6 set forth in Securities Exchange Act Release No. 25801, if promulgated, will not have a significant economic impact on a substantial number of small entities. The reasons for this certification are that (i) the exemption from broker-dealer registration under the proposed rule would be limited to foreign broker-dealers which need not be considered under 5 U.S.C. 603; and (ii) to the extent that the proposed rule, if adopted, would impose any costs on registered domestic broker-dealer affiliates of such foreign broker-dealers or have a competitive effect on other domestic broker-dealers those costs are not significant and would not impact a substantial number of small domestic broker-dealers.

Dated: June 14, 1988.

David S. Ruder,

Chairman.

[FR Doc. 88-14177 Filed 6-22-88; 8:45 am]

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DEPARTMENT OF STATE

Bureau of Public Affairs

22 CFR Part 9b

[SD-215]

Regulations Governing Department of State Press Building Passes

AGENCY: Department of State.

ACTION: Notice of proposed rulemaking.

SUMMARY: Since publication in the **Federal Register** in 1984 of the Department of State regulations governing press building passes, alterations have been made in procedures for physical access to the Main Department of State building to improve the safeguarding of the Department's personnel and classified and Limited Official Use material. To adjust to these access alterations, the Department of State proposes to change its regulations governing Department of State press building passes to reflect the following: That only State Department press building passes will be recognized by the automated access control system established in March 1988; that access by media correspondents and technicians with State Department press building passes is now limited after office hours and on weekends and holidays to designated areas without an escort; and that other procedures concerning the purpose, issuance, application and renewal procedures for a Department of State press building pass are being changed.

These proposed changes are being made to provide publicly available guidelines to the media on new access requirements for the Main Department of State building and to provide publicly available guidance on the procedures for issuance of a Department of State press building pass.

DATES: Comments must be received by July 25, 1988.

ADDRESSES: Comments should be sent to Director, Office of Press Relations, Room 2109, Department of State, 2201 C Street NW., Washington, DC 20520.

FOR FURTHER INFORMATION CONTACT: Nancy Beck at 202-647-2492.

SUPPLEMENTARY INFORMATION: The Department of State amends its regulations governing Department of State press building passes (22 CFR Part 9b) by proposing changes to identify and describe the means by which media correspondents and technicians may gain access to the Main Department of State building after the installation of an automated access control system established in March 1988, as well as access to the Main Department of State building outside of regular working hours and on weekends and holidays.

The Department of State also proposed changes which will better inform media correspondents and technicians as to the purposes of and procedures for issuing a Department of State press building pass.

Additionally, proposed changes have been made to reflect the current names of individuals and Department bureaus responsible for issuance of Department of State press building passes.

The Department of State voluntarily publishes these regulations in proposed form to allow for public comment.

This proposed rule is not a major rule for the purposes of Executive Order 12291 of February 17, 1981. As required by the Regulatory Flexibility Act, this proposed rule will not have a significant impact on small business entities. This

Federal Register

Tuesday,

July 8, 2008

Part IV

Securities and Exchange Commission

17 CFR Part 240

Exemption of Certain Foreign Brokers or Dealers; Proposed Rule

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

[Release No. 34–58047; File No. S7–16–08]

RIN 3235–AK15

Exemption of Certain Foreign Brokers or Dealers

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Securities and Exchange Commission (''Commission'' or ''SEC'') is proposing to amend a rule under the Securities Exchange Act of 1934 (''Exchange Act''), which provides conditional exemptions from broker-dealer registration for foreign entities engaged in certain activities involving certain U.S. investors. To reflect increasing internationalization in securities markets and advancements in technology and communication services, the proposed amendments would update and expand the scope of certain exemptions for foreign entities, consistent with the Commission's mission to protect investors, maintain fair, orderly and efficient markets and facilitate capital formation.

DATES: Comments should be received on or before September 8, 2008.

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's Internet comment form (*http://www.sec.gov/rules/proposed.shtml*); or
- Send an e-mail to *rule-comments@sec.gov.* Please include File Number S7–16–08 on the subject line; or
- Use the Federal eRulemaking Portal (*http://www.regulations.gov/*). Follow the instructions for submitting comments.

Paper Comments

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549–1090.

All submissions should refer to File Number S7–16–08. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. We will post all comments on the Commission's Internet Web site (*http://www.sec.gov/rules/proposed.shtml*). Comments are also available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: Erik R. Sirri, Director, Marlon Quintanilla Paz, Senior Counsel to the Director, Brian A. Bussey, Assistant Chief Counsel, Matthew A. Daigler, Special Counsel, or Max Welsh, Attorney, Office of the Chief Counsel, Division of Trading and Markets, at (202) 551–5500, at the Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549–6628.

SUPPLEMENTARY INFORMATION: The Commission is requesting public comment on the proposed amendments to Rule 15a–6 [17 CFR 240.15a–6] under the Exchange Act.

Table of Contents

I. Introduction and Background
II. The Regulatory Framework Under Rule 15a–6
A. Unsolicited Trades
B. Provision of Research Reports
C. Solicited Trades
D. Counterparties and Specific Customers
III. Proposed Amendments to Rule 15a–6
A. Extension of Rule 15a–6 to Qualified Investors
B. Unsolicited Trades
C. Provision of Research Reports
D. Solicited Trades
E. Counterparties and Specific Customers
F. Familiarization With Foreign Options Exchanges
G. Scope of the Proposed Exemption
IV. Preliminary Findings
V. General Request for Comment
VI. Administrative Law Matters
VII. Statutory Basis
VIII. Text of Proposed Amendments

I. Introduction and Background

Section 15(a) of the Exchange Act generally provides that, absent an exception or exemption, a broker or 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 must register with the Commission.[1] The Commission uses a territorial approach in applying the broker-dealer registration requirements to the international operations of broker-dealers.[2] Under this approach, broker-dealers located outside the United States that induce or attempt to induce securities transactions with persons in the United States are required to register with the Commission, unless an exemption applies.[3] Entities that conduct such activities entirely outside the United States do not have to register. Because this territorial approach applies on an entity level, not a branch level, if a foreign broker-dealer establishes a branch in the United States, broker-dealer registration requirements would extend to the entire foreign broker-dealer entity.[4] The registration requirements do not apply, however, to a foreign broker-dealer with an affiliate, such as a subsidiary, operating in the United States.[5] Only the U.S. affiliate must register and only the U.S. affiliate may engage in securities transactions and perform related functions on behalf of U.S. investors.[6] The territorial approach also requires registration of foreign broker-dealers operating outside the United States that effect, induce or attempt to induce securities transactions for any person inside the United States, other than a foreign person temporarily within the United States.[7]

In response to numerous inquiries seeking no-action relief and interpretive advice regarding whether certain international securities activities required U.S. broker-dealer registration, the Commission issued a release on June 14, 1988, to clarify the registration

[1] *See* 15 U.S.C. 78o(a)(1). Section 3(a)(4) of the Exchange Act generally defines a ''broker'' as ''any person engaged in the business of effecting transactions in securities for the account of others,'' but provides 11 exceptions for certain bank securities activities. Section 3(a)(5) of the Exchange Act generally defines a ''dealer'' as ''any person engaged in the business of buying and selling securities for his own account,'' but includes exceptions for certain bank activities. 15 U.S.C. 78c(a)(4). Exchange Act Section 3(a)(6) defines a ''bank'' as a bank or savings association that is directly supervised and examined by state or federal banking authorities (with certain additional requirements for banks and savings associations that are not chartered by a federal authority or a member of the Federal Reserve System). 15 U.S.C. 78c(a)(6). Accordingly, foreign banks that act as brokers or dealers within the jurisdiction of the United States are subject to U.S. broker-dealer registration requirements. *See* Exchange Act Release No. 27017 (Jul. 11, 1989), 54 FR 30013, 30015 n.16 (Jul. 18, 1989) (''1989 Adopting Release''); and Exchange Act Release No. 25801 (Jun. 14, 1988), 53 FR 23645 at n.1 (Jun. 23, 1988) (''1988 Proposing Release''). To the extent, however, that a 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), the Commission considers that branch or agency to be a ''bank'' for purposes of the exceptions from the ''broker'' and ''dealer'' definitions. *See* 1989 Adopting Release, 54 FR at 30015 n.16.

[2] *See* 1989 Adopting Release, 54 FR at 30016.

[3] *See id.*

[4] *See id.* at 30017.

[5] *See id.*

[6] *See id.*

[7] *See id.* For contacts by foreign broker-dealers with U.S. citizens domiciled abroad, the Commission generally does not require registration. Paragraph (a)(4)(v) of Rule 15a–6 specifically addresses this situation.

requirements for foreign-based broker-dealers, foreign affiliates of U.S. broker-dealers, and other foreign financial institutions.[8] The release also proposed Rule 15a–6, which provided conditional exemptions from registration under Section 15(b) of the Exchange Act for foreign broker-dealers that induce or attempt to induce the purchase or sale of any security by certain U.S. institutional investors, if the foreign broker-dealer satisfied certain conditions. The Commission adopted Rule 15a–6 on July 11, 1989, and it became effective August 15, 1989.[9]

While the rule has provided a useful framework for certain U.S. investors to access foreign broker-dealers for almost two decades, ever increasing market globalization suggests that it is time to revisit that framework to consider whether it could be made more workable, consistent with the Commission's mission to protect investors, maintain fair, orderly and efficient markets and facilitate capital formation.

As discussed below, the amendments we propose today would generally expand the category of U.S. investors that foreign broker-dealers may contact for the purpose of providing research reports and soliciting securities transactions. The proposed amendments would also reduce the role U.S. registered broker-dealers must play in intermediating transactions effected by foreign broker-dealers on behalf of certain U.S. investors. Proposed new safeguards are intended to ensure that the expanded exemptions would remain consistent with the Commission's statutory mandate.

II. The Regulatory Framework Under Rule 15a–6

As discussed below, Rule 15a–6 provides conditional exemptions from broker-dealer registration for foreign broker-dealers that engage in certain activities involving certain U.S. investors. Paragraph (b)(3) of the rule defines a ''foreign broker-dealer'' as ''any non-U.S. resident person * * * that is not an office or branch of, or a natural person associated with, a registered broker-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 Act.''[10] Among the activities that foreign broker-dealers may engage in under the rule are: (i) ''Nondirect'' contacts by foreign broker-dealers with U.S. investors through execution of unsolicited securities transactions and the provision of research reports to certain U.S. institutional investors and (ii) ''direct'' contacts, involving the execution of transactions through a registered broker-dealer intermediary with or for certain U.S. institutional investors, and without this intermediary with or for certain entities such as registered broker-dealers and banks acting in a broker or dealer capacity.[11]

A. Unsolicited Trades

As we explained in adopting Rule 15a–6, a broker-dealer that solicits a transaction with a U.S. investor must be registered with the Commission.[12] Because the Commission determined that, as a policy matter, registration is not necessary if a U.S. investor initiated a transaction with a foreign broker-dealer entirely by his or her own accord, paragraph (a)(1) of Rule 15a–6 [13] provides an exemption for a foreign-broker dealer that effects unsolicited securities transactions with U.S. persons.[14] As the Commission expressed in adopting Rule 15a–6, solicitation is construed broadly as ''any affirmative effort by a broker or dealer intended to induce transactional business for the broker-dealer or its affiliates.'' [15] For example, the Commission views telephone calls to U.S. investors, advertising circulated or broadcast in the United States and holding investment seminars in the United States, regardless of whether the seminars were hosted by a registered broker-dealer, as forms of solicitation.[16] Solicitation also includes recommending the purchase or sale of securities to customers or prospective customers for the purpose of generating transactions.[17]

The exemption in paragraph (a)(1) is intended to allow a foreign broker-dealer to effect transactions with U.S. investors when the foreign broker-dealer does not make any affirmative effort to induce transactional activity with the U.S. investor. Because of the breadth of the meaning of solicitation in the broker-dealer registration context, this exemption typically would not be a viable basis for a foreign broker-dealer to conduct an ongoing business, which would likely involve some form of solicitation, in the United States.[18]

B. Provision of Research Reports

The provision of research to investors also may constitute solicitation by a broker or dealer that would require broker-dealer registration.[19] Broker-dealers often provide research to customers with the expectation that the customer eventually will trade through the broker-dealer.[20] Paragraph (a)(2) of Rule 15a–6 [21] provides an exemption from U.S. broker-dealer registration for foreign broker-dealers that provide research reports to certain institutional investors under conditions that are designed to permit the flow of research without allowing foreign broker-dealers to do more to solicit transactions with U.S. investors.[22]

In particular, the rule exempts from U.S. broker-dealer registration a foreign broker-dealer that provides research to certain U.S. institutional investors if (i) the research reports do not recommend that the investor use the foreign broker-dealer to effect trades in any security, (ii) the foreign broker-dealer does not initiate follow up contacts or otherwise induce or attempt to induce investors to effect transactions in any security, (iii) transactions with the foreign broker-dealer in securities covered by the research reports are effected through a registered broker-dealer according to the provisions of paragraph (a)(3) of the rule, described below, and (iv) the provision of research is not pursuant to an understanding that the foreign broker-dealer will receive commission income from transactions effected by U.S. investors.[23]

The exemption in paragraph (a)(2) of Rule 15a–6 is available only with

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[8] *See* 1988 Proposing Release.

[9] 17 CFR 240.15a–6. *See* 1989 Adopting Release.

[10] 17 CFR 240.15a–6(b)(3).

[11] *See* 1989 Adopting Release, 54 FR at 30013.

[12] *See id.* at 30017.

[13] 17 CFR 240.15a–6(a)(1).

[14] *See* 1989 Adopting Release, 54 FR at 30017.

[15] *See id.*

[16] *See id.* at 30017–18.

[17] *See id.*

[18] *See id.*; *see also* Exchange Act Release No. 39779, ''Interpretation Re: Use of Internet Web Sites To Offer Securities, Solicit Securities Transactions, or Advertise Investment Services Offshore'' (Mar. 23, 1998), 63 FR 14806, 14813 (Mar. 27, 1998) (stating that ''[f]oreign broker-dealers that have Internet Web sites and that intend to rely on Rule 15a–6's 'unsolicited' exemption should ensure that the 'unsolicited' customer's transactions are not in fact solicited, either directly or indirectly, through customers accessing their Web sites.'').

[19] *See* 1989 Adopting Release, 54 FR at 30021–22.

[20] *See id.* (''Broker-dealers often provide research to customers on a non-fee 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 non-fee 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.'').

[21] 17 CFR 240.15a–6(a)(2).

[22] *See* 17 CFR 240.15a–6(a)(2).

[23] *See id.*

respect to research reports that are furnished to ''major U.S. institutional investors.'' Paragraph (b)(4) of the rule defines a ''major U.S. institutional investor'' as (i) a U.S. institutional investor [24] that has, or has under management, total assets in excess of $100 million (which 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.[25]

C. Solicited Trades

As we discussed in adopting Rule 15a–6, although many foreign broker-dealers have established registered broker-dealer affiliates to deal with U.S. investors and trade in U.S. securities, they may prefer to deal with institutional investors in the United States from their overseas trading desks, where their dealer operations and principal sources of current information on foreign market conditions and foreign securities are based.[26] For similar reasons, many U.S. institutions want direct contact with overseas traders. Except for limited instances of unsolicited transactions, such contact would require the foreign broker-dealer to register with the Commission.

Paragraph (a)(3) of Rule 15a–6 [27] provides an exemption for foreign broker-dealers that induce or attempt to induce securities transactions by certain institutional investors, if a U.S. registered broker-dealer intermediates certain aspects of the transactions by carrying out specified functions. In particular, the U.S. registered broker-dealer is required to effect all aspects of the transaction (other than negotiation of the terms).[28] It must issue all required confirmations [29] and account statements to the U.S. institutional investor or major U.S. institutional investor. As the Commission explained, these documents are significant points of contact between the investor and the broker-dealer, and they provide important information for investors.[30] Also, as between the foreign broker-dealer and the U.S. registered broker-dealer, the latter is required to extend or arrange for the extension of any credit to these investors in connection with the purchase of securities.[31] In addition, the U.S. registered broker-dealer is responsible for maintaining required books and records relating to the transactions conducted under paragraph (a)(3) of the rule, including those required by Rules 17a–3 and 17a–4,[32] which facilitates Commission supervision and investigation of these transactions.[33] Of course, the U.S. registered broker-dealer also must maintain sufficient net capital in compliance with Exchange Act Rule 15c3–1,[34] and receive, deliver and safeguard funds and securities in connection with the transactions in compliance with Exchange Act Rule 15c3–3.[35] Furthermore, the U.S. registered broker-dealer must take responsibility for certain key sales activities, including ''chaperoning'' the contacts of foreign associated persons with certain U.S. institutional investors.[36]

In adopting Rule 15a–6, the Commission pointed out that the U.S. registered broker-dealer's intermediation is intended to help protect U.S. investors and securities markets.[37] For example, the U.S. registered broker-dealer has an obligation, as it has for all customer accounts, to review any Rule 15a–6(a)(3) account for indications of potential problems.[38]

This exemption in Rule 15a–6(a)(3) applies to transactions with major U.S. institutional investors, described above, as well as ''U.S. institutional investors.'' The rule defines a ''U.S. institutional investor'' as (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 (''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).[39]

D. Counterparties and Specific Customers

Paragraph (a)(4) of Rule 15a–6 [40] provides an exemption for foreign broker-dealers that effect transactions in securities with or for, or induce or attempt to induce the purchase or sale of securities by, five categories of persons: (1) Registered broker-dealers (acting either as principal or for the account of others) or banks acting pursuant to an exception or exemption from the definition of ''broker'' or ''dealer'' in Sections 3(a)(4)(B), 3(a)(4)(E), or 3(a)(5)(C) of the Exchange Act or the rules thereunder; [41] (2) certain international organizations and their agencies, affiliates and pension funds; [42]

[24] *See* Part II.C., *infra*, for discussion of the definition of ''U.S. institutional investor.''

[25] *See* 17 CFR 240.15a–6(b)(4); *cf.* Letter from Richard R. Lindsey, Director, Division of Market Regulation, to Mr. Giovanni P. Prezioso, Cleary Gottlieb, Steen & Hamilton (Apr. 9, 1997) (''1997 Staff Letter'').

[26] *See* 1989 Adopting Release, 54 FR at 30024.

[27] 17 CFR 240.15a–6(a)(3).

[28] 17 CFR 240.15a–6(a)(3)(iii)(A). In adopting Rule 15a–6, the Commission recognized that rules of foreign securities exchanges and over-the-counter markets may require the foreign broker-dealer, as a member or market maker, to perform the actual physical execution of transactions in foreign securities listed on those exchanges or traded in those markets. *See* 1989 Adopting Release, 54 FR at 30029 n.185. For this reason, the Commission stated that, while it does not believe that it is appropriate to allow the U.S. registered broker-dealer to delegate the performance of its duties under the rule to the foreign broker-dealer, it would permit such delegation in the case of physically executing foreign securities trades in foreign markets or on foreign exchanges. *See* 1989 Adopting Release, 54 FR at 30025; cf. 1997 Staff Letter. As a result, the treatment of U.S. securities and foreign securities under paragraph (a)(3) of the rule differs. Specifically, with foreign securities the foreign broker-dealer may not only negotiate the terms, but also execute the transactions in the circumstances specified in the Adopting Release. *See* 1989 Adopting Release, 54 FR at 30029 n.185; cf. NASD Rule 6620(g)(2) (trade reporting of transactions in foreign equity securities not required when the transaction is executed on and reported to a foreign securities exchange or over the counter in a foreign country and reported to the foreign regulator). With respect to U.S. securities, however, the U.S. broker-dealer is required to execute the transactions and to comply with the provisions of the federal securities laws, the rules thereunder and SRO rules applicable to the execution of transactions.

[29] *See* Rule 10b–10, 17 CFR 240.10b–10. *See* 17 CFR 240.15a–6(a)(3)(iii)(A)(2).

[30] *See* 1989 Adopting Release, 54 FR at 30029.

[31] 17 CFR 240.15a–6(a)(3)(iii)(A)(3).

[32] 17 CFR 240.17a–3 and 17a–4. *See* 17 CFR 240.15a–6(a)(3)(iii)(A)(4).

[33] *See* 1989 Adopting Release, 54 FR at 30029.

[34] 17 CFR 240.15c3–1. *See* 17 CFR 240.15a–6(a)(3)(iii)(A)(5).

[35] 17 CFR 240.15c3–3. *See* 17 CFR 240.15a–6(a)(3)(iii)(A)(6); cf. 1997 Staff Letter.

[36] *See* 17 CFR 240.15a–6(a)(3)(ii)(A) and (a)(3)(iii)(B); *cf.* 1997 Staff Letter.

[37] *See* 1989 Adopting Release, 54 FR at 30025.

[38] *See id.* While the rule does not require the U.S. registered broker-dealer to implement procedures to obtain positive assurance that the foreign broker-dealer is operating in accordance with U.S. requirements, the U.S. registered broker-dealer, in effecting trades arranged by the foreign broker-dealer, has a responsibility to review these trades for indications of possible violations of the federal securities laws. *Id.*

[39] *See* 17 CFR 240.15a–6(b)(7).

[40] 17 CFR 240.15a–6(a)(4).

[41] While the exemption allows foreign broker-dealers to effect transactions with or for certain banks or registered broker-dealers, it does not allow direct contact by foreign broker-dealers with the U.S. customers of the registered broker-dealers or banks. *See* 1989 Adopting Release, 54 FR at 30013 n.202.

[42] The organizations are the African Development Bank, the Asian Development Bank, the Inter-American Development Bank, the International Bank for Reconstruction and Development, the International Monetary Fund, the United Nations. *See* 17 CFR 240.15a–6(a)(4)(ii).

(3) foreign persons temporarily present in the United States with whom the foreign broker-dealer had a pre-existing relationship; (4) any agency or branch of a U.S. person permanently abroad; and (5) U.S. citizens resident outside the United States, as long as the transactions occur outside the United States and the foreign broker-dealer does not target solicitations at identifiable groups of U.S. citizens resident abroad.

III. Proposed Amendments to Rule 15a–6

The pace of internationalization in securities markets around the world has continued to accelerate since we adopted Rule 15a–6 in 1989. Advancements in technology and communication services have provided greater access to global securities markets for all types of investors.[43] U.S. investors are seeking to take advantage of this increased access by seeking more direct contact with those expert in foreign markets and foreign securities. In addition, discussions over the years with industry representatives regarding Rule 15a–6 have suggested areas where the rule could be revised to achieve its objectives more effectively without jeopardizing investor protections.[44]

In response to these developments and suggestions, the Commission is proposing to amend Rule 15a–6 to remove barriers to access while maintaining key investor protections. In general, and as discussed more fully in Part III.G. below, the proposed amendments would expand and streamline the conditions under which a foreign broker-dealer could operate without triggering the registration requirements of Section 15(a)(1) or 15B(a)(1) of the Exchange Act and the reporting and other requirements of the Exchange Act (other than Sections 15(b)(4) and 15(b)(6)), and the rules and regulations thereunder, that apply specifically to a broker-dealer that is not registered with the Commission solely by virtue of its status as a broker or dealer, while maintaining a regulatory structure designed to protect investors and the public interest.[45]

A. Extension of Rule 15a–6 to Qualified Investors

The proposed rule would expand the category of U.S. investors with which a foreign broker-dealer[46] could interact under Rule 15a–6(a)(2) and would expand, with a few exceptions, the category of U.S. investors with which a foreign broker-dealer could interact under Rule 15a–6(a)(3) by replacing the categories of ''major U.S. institutional investor'' and ''U.S. institutional investor'' with the category of ''qualified investor,'' as defined in Section 3(a)(54) of the Exchange Act.[47] In adopting the definitions of ''U.S. institutional investor'' and ''major U.S. institutional investor,'' the Commission expressed the view that institutions with the major U.S. institutional investor ''level of assets are more likely to have the skills and experience to assess independently the integrity and competence of the foreign broker-dealers providing [foreign market] access.''[48] As discussed below, we believe that advancements in communications and other technology have made it increasingly likely that a broader range of persons would have these skills and experience at a lower asset level.

The proposed rule would give the term ''qualified investor'' the same meaning as set forth in Section 3(a)(54) of the Exchange Act.[49] The qualified investor standard is well known to the financial community. Section 3(a)(54)(A) defines a ''qualified investor'' as:

(i) Any investment company registered with the Commission under Section 8 of the Investment Company Act of 1940 (''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 that 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);[50]

(x) The government of any foreign country;[51]

(xi) Any corporation, company, or partnership that owns and invests on a

[43] *See, e.g.,* Spotlight On: Roundtable Discussions Regarding Mutual Recognition (Jun. 12, 2007) (available at: *http://www.sec.gov/spotlight/mutualrecognition.htm).*

[44] *See, e.g., id.*

[45] *See* Part III.G., *infra*, regarding the scope of the exemption.

[46] The definition of ''foreign broker or dealer ''in the proposed rule would be the same as in the current rule, except as described below. *See* proposed Rule 15a–6(b)(2).

[47] The proposed rule would also eliminate the definition of ''family of investment companies,'' which is currently used in the definition of ''major U.S institutional investor, ''because it would no longer be needed. *See* 17 CFR 240.15a–6(b)(1), (4) and (7).

[48] 1989 Adopting Release, 54 FR at 30027. In proposing the definition of ''U.S. institutional investor,'' the Commission stated that ''[t]he proposed asset limitation in the rule is based on the assumption that direct U.S. oversight of the competence and conduct of foreign sales personnel may be of less significance where they are soliciting only U.S. institutional investors with high levels of assets. The $100 million asset level * * * is designed to increase the likelihood that the institution or its investment advisers have prior experience in foreign markets that provides insight into the reliability and reputation of various foreign broker-dealers.'' 1988 Proposing Release, 53 FR 23654.

[49] 15 U.S.C. 78c(54). The definition of ''qualified investor'' was added to the Exchange Act by the Gramm-Leach-Bliley-Act of 1999 (Pub. L. 106–102, 113 Stat. 1338 (1999)) and has application to several of the bank exceptions from broker-dealer registration, including: (1) the broker exception for identified banking products when the product is an equity swap agreement (Section 206(a)(6) of Pub. L. 106–102, 15 U.S.C. 78c note, as incorporated into Exchange Act Section 3(a)(4)(B)(ix), 15 U.S.C. 78c(a)(4)(B)(ix)); (2) the dealer exception for identified banking products when the product is an equity swap agreement (Section 206(a)(6) of Pub. L. 106–102, 15 U.S.C. 78c note, as incorporated into Exchange Act Section 3(a)(5)(C)(iv), 15 U.S.C. 78c(a)(5)(C)(iv)); and (3) the dealer exception for asset-backed securities (Exchange Act Section 3(a)(5)(C)(iii), 15 U.S.C. 78c(a)(5)(C)(iii)). These exceptions permit banks to sell certain securities to qualified investors without registering as broker-dealers with the Commission.

[50] The definition of qualified investor includes any foreign bank. Unlike foreign governments (*see* note 51, *infra*), foreign banks may establish a permanent presence in the United States, such as a branch, that would not qualify under Exchange Act Section 3(a)(6) as a bank. *See* note 1, *supra*. Foreign broker-dealers need to rely on Rule 15a–6 to effect transactions with such entities.

[51] Of course, foreign broker-dealers currently do not need to rely on Rule 15a–6 to effect transactions with foreign governments because foreign governments are neither located in the United States nor U.S. persons resident abroad.

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 Commission proposes to use the definition of ''qualified investor'' in section 3(a)(54) of the Exchange Act for several reasons primarily related to the sophistication and likely experience with foreign securities and foreign markets of the investors included in the definition. For example, the entities described in paragraphs (i) through (ix) of Section 3(a)(54)(A) of the Exchange Act, without limitation based on ownership or investment, are all engaged primarily in financial activities, including the business of investing. The persons in paragraphs (xi), (xii) and (xiii) of Section 3(a)(54)(A) are not primarily engaged in investing and may have limited investment experience. Thus, Congress established ownership and investment thresholds for those latter persons as indicators of investment experience and sophistication.[52] The Commission believes that Congress' standard for investors with significant investment experience and sophistication to deal with banks that are not registered as broker-dealers should ensure that these investors would possess sufficient experience with financial matters to be able to enter into securities transactions with foreign broker-dealers under the proposed exemption. Thus, the Commission believes that it would be appropriate and consistent with the protection of investors to extend the relief in proposed Rules 15a–6(a)(2) and (a)(3) to a corporation, company, partnership that, or a natural person who, owns and invests on a discretionary basis not less than $25,000,000 in investments, and to a 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.

The primary distinction between a major U.S. institutional investor and a qualified investor is the threshold value of assets or investments owned or invested and the inclusion of natural persons. As a result, under the proposed rule, the threshold would decline from institutional investors that own or control greater than $100 million in total assets to, among others, all investment companies registered with the Commission under Section 8 of the Investment Company Act and corporations, companies, or partnerships that own or invest on a discretionary basis $25 million or more in investments. In addition, under the proposed rule, natural persons who own or invest on a discretionary basis not less than $25,000,000 in investments would be included. In adopting Rule 15a–6, we explained that the $100 million asset level was designed ''to increase the likelihood that [the investor has] prior experience in foreign markets that provides insight into the reliability and reputation of various foreign broker-dealers.'' [53] While we believe this is still the right focus, increased access to information about foreign securities markets due to advancements in communication technology suggest that a broader spectrum of investors are likely to have this type of sophistication.

We believe that the proposed use of the definition of qualified investor would more accurately encompass persons that have prior experience in foreign markets and an appropriate level of investment experience and sophistication overall. In certain instances, it would exclude persons that are currently included in the definition of U.S. institutional investor or major U.S. institutional investor. In each such instance, the proposed use of the definition of qualified investor would require greater investment experience of the entity than the current definition.

For example, with respect to employee benefit plans, the definition of qualified investor includes plans in which investment decisions are made by certain plan fiduciaries. The definition of U.S. institutional investor does not require a fiduciary to make investment decisions and encompasses plans with $5 million or more in assets. While there is no asset requirement in the employee benefit plan section in the definition of qualified investor, the Commission believes that proposing to require investment decisions to be made by plan fiduciaries as a qualification for the definition would help ensure a higher level of investing experience and sophistication than a $5 million asset threshold. Similarly, while a qualified investor applies to trusts whose purchases are directed by certain entities, the definition of ''U.S. institutional investor'' does not impose that limitation, but instead applies to certain trusts with $5 million or more in assets. Also, while the proposed definition (like the existing definition) would encompass business development companies as defined in Section 2(a)(48) of the Investment Company Act, the definition of ''U.S. institutional investor'' extends to private business development companies defined in Section 202(a)(22) of the Investment Advisers Act of 1940. The definition of ''U.S. institutional investor,'' unlike the definition of ''qualified investor,'' further applies to certain organizations described in Section 503(c) of the Internal Revenue Code with assets of $5 million or more. Proposing to require the higher level of investing experience and sophistication would be appropriate in light of the expanded activities in which foreign broker-dealers would be permitted to engage under the proposed rule, as well as the reduced role that would be played by the U.S. registered broker-dealer.

The Commission requests comment on the proposed use of the definition of ''qualified investor'' generally and, more specifically, whether allowing foreign broker-dealers to induce or attempt to induce transactions with the persons included in the proposed definition is appropriate. Are the ownership and investment thresholds applicable to certain persons included in the proposed use of the definition of ''qualified investor'' appropriate? Does the definition encompass investors that likely would have an appropriate level of investing or business experience in foreign markets? If not, why not? Should the definition be tailored to include only investors that have a demonstrated pattern of appropriate transactional activity with U.S. registered or foreign broker-dealers in foreign securities? If so, how?

The Commission also requests comment on whether the proposed use of the definition of ''qualified investor'' should include additional minimum asset levels for any of the persons included in Exchange Act Section 3(a)(54). For example, should the proposed rule use a new definition that includes a requirement that a small business investment company own and invest a certain amount of investments? Should it include any of the omitted

[52] *See* 15 U.S.C. 6801 *et seq.,* Pub. L. 106–102, 113 Stat. 1338 (1999). Congress did not include an ownership or investment threshold for multinational or supranational entities, or any agencies or instrumentalities thereof, presumably regarding such entities as possessing sufficient financial sophistication, net worth and knowledge and experience in financial matters to be considered a qualified investor. Exchange Act Release No. 47364 (Feb. 13, 2003), 68 FR 8686, 8693 (Feb. 24, 2003).

[53] *See* 1989 Adopting Release, 54 FR at 30027.

categories of persons from the definition of ''U.S. institutional investor''? Are there any categories of investors included in the proposed use of the definition of qualified investor that should be excluded, such as market intermediaries exempt under Section 3(c)(2) of the Investment Company Act?

In addition, the Commission requests comment on whether the proposed use of the definition of ''qualified investor'' should include natural persons who own or invest on a discretionary basis at least $25,000,000 in investments. If not, should the Commission adopt a different threshold level of investments or ownership? What criteria, if any, should apply to help ensure that a natural person would have sufficient investment experience and sophistication specifically in foreign securities? Are there additional safeguards for natural persons that would be appropriate to include in the rule, such as increasing the involvement of U.S. registered broker-dealers in transactions solicited by foreign broker-dealers? For example, foreign broker-dealers could be required to make suitability determinations before sales to natural persons under the exemption. If additional safeguards applied to transactions with natural persons who own or invest on a discretionary basis at least $25,000,000 in investments, would foreign broker-dealers choose to comply with those safeguards or choose not to do business directly with natural persons under such a rule? Finally, should any of the dollar thresholds in the proposed use of the definition of qualified investor be adjusted for inflation? If so, what mechanism should be used to make such adjustments?

B. Unsolicited Trades

As we noted in adopting Rule 15a–6, although the requirements of Section 15(a) under the Exchange Act do not distinguish between solicited and unsolicited transactions, the Commission does not believe, as a policy matter, that registration is necessary if U.S. investors have sought out foreign broker-dealers outside the United States and initiated transactions in foreign securities markets entirely of their own accord.[54] In that event, U.S. investors would have taken the initiative to trade outside the United States with foreign broker-dealers that are not conducting activities within this country and the U.S. investors would have little reason to expect these foreign broker-dealers to be subject to U.S. broker-dealer requirements.[55] Therefore, the Commission is not proposing to amend paragraph (a)(1) of the current rule, other than to add the title ''Unsolicited Trades.'' Notably, in order to rely on this exemption, foreign broker-dealers need to determine whether each transaction effected in reliance on it has been solicited under the proposed rule.

Because the Commission construes solicitation broadly and relatively few transactions qualify for the unsolicited exemption,[56] the Commission is proposing to provide further interpretive guidance related to solicitation under the proposed rule with respect to quotation systems. In adopting the current rule, we noted that access to foreign market makers' quotations is of considerable interest to registered broker-dealers and institutional investors that seek timely information on foreign market conditions.[57] The Commission also stated that it generally would not consider a solicitation to have occurred for purposes of Rule 15a–6 if there were a U.S. distribution of foreign broker-dealers' quotations by third-party systems, such as systems operated by foreign marketplaces or by private vendors, that distributed these quotations primarily in foreign countries.[58] The Commission's position applies only to third-party systems that do not allow securities transactions to be executed between the foreign broker-dealer and persons in the United States through the systems.[59] The Commission noted that it would have reservations about certain specialized quotation systems, which might constitute a more powerful inducement to effect trades because of the nature of the proposed transactions.[60] With respect to direct dissemination of a foreign market maker's quotations to U.S. investors, such as through a private quote system controlled by a foreign broker-dealer (as distinct from a third-party system), the Commission noted in adopting the current rule that such conduct would not be appropriate without registration, because the dissemination of these quotations would be a direct, exclusive inducement to trade with that foreign broker-dealer.[61]

Since the time the current rule was adopted, third-party quotation systems have become increasingly global in scope such that the distinction between systems that distribute quotations primarily in the United States and those that distribute quotations primarily in foreign countries is no longer a meaningful or workable distinction because most third-party quotation systems no longer serve a primary location.[62] As a result, under the Commission's proposed interpretation, the Commission's previous guidance on U.S. distribution of foreign broker-dealers' quotations by third-party systems no longer would be limited to third-party systems that distributed their quotations primarily in foreign countries under the proposed rule. In other words, under the proposed interpretation, U.S. distribution of foreign broker-dealers' quotations by a third-party system (which did not allow securities transaction to be executed between the foreign broker-dealer and persons in the U.S. through the system) would not be viewed as a form of solicitation, in the absence of other contacts with U.S. investors initiated by the third-party system or the foreign broker-dealer.

The Commission seeks comment regarding whether retaining the proposed Unsolicited Trades exemption in paragraph (a)(1) is appropriate. Are any modifications to this exemption necessary to reflect increasing internationalization in securities markets and advancements in technology and communication services since the exemption was adopted in 1989? Commenters are invited to provide information on the specific circumstances in which foreign broker-dealers use the exemption in paragraph (a)(1) of the current rule and particularly on the frequency of its use. The Commission also seeks comment on its proposed interpretation with respect to third-party quotation systems under the proposed rule. Are there other interpretive issues relating to third-party

[54] *See* 1989 Adopting Release, 54 FR at 30017.

[55] *See id.*

[56] *See id.* at 30021.

[57] *See id.* at 30017.

[58] *See id.*

[59] *See id.*

[60] *See id.* at n.66. For example, the Commission stated that a foreign broker-dealer whose quotations were displayed in a system that disseminated quotes only for large block trades might well be deemed to have engaged in solicitation requiring broker-dealer registration, as opposed to a foreign broker-dealer whose quotes were displayed in a system that disseminated the quotes of numerous foreign dealers or market makers in the same security. *See id.*

[61] *See id.* at 30019. In making the statement that the conduct would not be appropriate ''without registration, ''the Commission did not intend to preclude a foreign broker-dealer from directly inducing U.S. investors to trade with the foreign broker-dealer via such a quotation system where the U.S. investor subscribes to the quotation system through a U.S. broker-dealer, the U.S. broker-dealer has continuing access to the quotation system, the foreign broker-dealer's other contacts with the U.S. investor are permissible under the current rule and any resulting transactions are intermediated in accordance with the requirements of Rule 15a–6(a)(3).

[62] *Cf.* 1997 Staff Letter.

quotation systems, or proprietary quotation systems, that the Commission should address? Is guidance needed under the Commission's interpretation of solicitation for other entities, such as third-party or proprietary systems that provide indications of interest, for purposes of the proposed amendments of Rule 15a–6?

Because one of the requirements for being an alternative trading system under Regulation ATS [63] is to be registered as a broker-dealer under Section 15(b) of the Exchange Act, a foreign broker-dealer relying on an exemption in proposed Rule 15a–6 would not be eligible to rely on the exemption in Regulation ATS. The Commission solicits comment on whether it should consider amending Regulation ATS to allow a foreign broker-dealer relying on an exemption in proposed Rule 15a–6 to operate an alternative trading system in the United States so long as it otherwise complies with the terms of Regulation ATS.

C. Provision of Research Reports

The provision of research to investors also may constitute solicitation by a broker-dealer, in part because broker-dealers often provide research to customers on a non-fee basis, with the expectation that the customers eventually will trade through the broker-dealer.[64] As we noted in adopting Rule 15a–6, the Commission does not wish to restrict the ability of U.S. investors to obtain foreign research reports in the United States if adequate regulatory safeguards are present.[65] Therefore, the Commission would retain the current exemption for the provision of research reports in paragraph (a)(2) of the current rule. However, for the reasons discussed above,[66] the Commission is proposing to expand the class of investors to which the foreign broker-dealer could provide research reports directly from major U.S. institutional investors to qualified investors. As proposed, paragraph (a)(2) would permit a foreign broker-dealer, subject to the conditions discussed below, to furnish research reports to qualified investors and effect transactions in the securities discussed in the research reports with or for those qualified investors.

Paragraph (a)(2) of the proposed rule would retain the conditions in current Rule 15a–6(a)(2), modified solely to reflect the proposed expansion of the class of investors to qualified investors. Specifically, proposed paragraph (a)(2) would be available, provided that: (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 the qualified investors to follow up on the research reports and does not otherwise induce or attempt to induce the purchase or sale of any security by the qualified investors; (3) if the foreign broker-dealer has a relationship with a registered broker-dealer that satisfies the requirements of paragraph (a)(3) of the proposed rule, any transactions with the foreign broker-dealer in securities discussed in the research reports are effected pursuant to the provisions of paragraph (a)(3); and (4) the foreign broker-dealer does not provide research to U.S. persons pursuant to any express or implied understanding that those U.S. persons will direct commission income to the foreign broker-dealer. We understand from discussions with industry representatives that these conditions have been workable for both foreign broker-dealers and U.S. registered broker-dealers and we have no knowledge of investor protection concerns having been raised with regard to foreign broker-dealers that operate in compliance with the current exemption. Accordingly, we do not propose to amend them.

If these conditions are met, the Commission proposes to allow the foreign broker-dealer to effect transactions in the securities discussed in a research report at the request of a qualified investor. The Commission believes that, under the proposed conditions, the direct distribution of research to qualified investors would be consistent with the free flow of information across national boundaries without raising substantial investor protection concerns.[67]

The Commission seeks comment on the proposed ''Research Reports'' exemption in paragraph (a)(2). Should any of the conditions of the current exemption be changed to address the proposed expansion of the class of institutional investors to which research reports may be distributed directly, or to reflect increasing internationalization in securities markets and advancements in technology and communication services since the exemption was adopted in 1989? If so, how? Similarly, should any of the conditions of the current exemption be changed to more closely align with the proposed modifications to the requirements of paragraph (a)(3) discussed below in Part III.D.? If so, how? Commenters are invited to provide information on the specific circumstances in which foreign broker-dealers use the exemption in paragraph (a)(2) of the current rule and on the frequency of its use.

D. Solicited Trades

The proposed rule would significantly revise the conditions under which a foreign broker-dealer could induce or attempt to induce the purchase or sale of a security by certain U.S. investors under paragraph (a)(3) of Rule 15a–6. Overall, and as discussed more fully below, the proposed rule would reduce and streamline the obligations of the U.S. registered broker-dealer in connection with these transactions and, in certain situations, permit a foreign broker-dealer to provide full-service brokerage by effecting securities transactions on behalf of qualified investors and maintaining custody of qualified investor funds and securities relating to any resulting transactions.

1. Customer Relationship

The proposed rule would require a foreign broker-dealer that induces or attempts to induce the purchase or sale of any security by a qualified investor to engage a U.S. registered broker-dealer under one of two exemptive approaches, to which we will refer as Exemption (A)(*1*) and Exemption (A)(*2*), corresponding to paragraphs (a)(3)(iii)(A)(*1*) and (A)(*2*) of the proposed rule.[68] As explained below, under both proposed exemptions, the U.S. registered broker-dealer would have fewer obligations than under paragraph (a)(3) of the current rule and the foreign broker-dealer would correspondingly be permitted to play a greater role in effecting any resulting transactions. Both proposed exemptions would allow qualified investors the more direct contact they seek with those expert in foreign markets and foreign securities, without certain barriers such as the chaperoning requirements that may be unnecessary in light of other protections and investor sophistication. Nevertheless, as explained below, both proposed exemptions would retain important measures of investor protection that the Commission believes would, among other things, address the potential risks to qualified investors related to contacts with foreign associated persons with a disciplinary history and ensure that the books and records related to transactions for U.S. investors are available to the Commission.

[63] *See* 17 CFR 242.300 *et seq.*

[64] *See* 1989 Adopting Release, 54 FR at 30021.

[65] *See id.*

[66] *See* Part III.A., *supra.*

[67] *See* 1989 Adopting Release, 54 FR at 30021.

[68] *See* proposed Rule 15a–6(a)(3)(iii)(A).

There are two primary differences between the two proposed exemptive approaches. First, Exemption (A)(*1*) could only be used by foreign broker-dealers that conduct a ''foreign business,'' [69] while Exemption (A)(*2*) could be used by all foreign broker-dealers. Second, the foreign broker-dealer would be permitted to custody funds and securities of qualified investors in connection with resulting transactions under Exemption (A)(*1*), but not under Exemption (A)(*2*). These distinctions are discussed in the following paragraphs.

a. Exemption (A)(*1*)

i. Role of the U.S. Registered Broker-Dealer

For transactions effected by a foreign broker-dealer pursuant to proposed Exemption (A)(*1*),[70] a U.S. registered broker-dealer would be required to maintain copies of all books and records, including confirmations and statements issued by the foreign broker-dealer to the qualified investor, relating to any such transactions.[71] As discussed below, the proposed rule would allow such books and records to be maintained by the U.S. registered broker-dealer in the form, manner and for the periods prescribed by the foreign securities authority (as defined in Section 3(a)(50) of the Exchange Act) [72] regulating the foreign broker-dealer.[73] The proposed rule would give the term ''foreign securities authority'' the same meaning as set forth in Section 3(a)(50) of the Exchange Act,[74] which defines ''foreign securities authority'' to mean ''any foreign government, or any governmental body or regulatory organization empowered by a foreign government to administer or enforce its laws as they relate to securities matters.''

Because proposed Exemption (A)(*1*) would allow a foreign broker-dealer to effect transactions for qualified investors and custody their funds and assets, the foreign broker-dealer would generate books and records relating to the transactions. Proposed Exemption (A)(*1*) would allow the U.S. registered broker-dealer to maintain such books and records with the foreign broker-dealer, provided that the U.S. registered broker-dealer makes a reasonable determination that copies of any or all of such books and records could be furnished promptly to the Commission and promptly provides any such books and records to the Commission, upon request.[75] In making such a determination, the U.S. registered broker-dealer would need to consider, among other things, the existence of any legal limitations in the foreign jurisdiction that might limit the ability of the foreign broker-dealer to disclose information relating to transactions conducted pursuant to proposed Exemption (A)(*1*) to the U.S. registered broker-dealer. Proposing to require U.S. registered broker-dealers to make a reasonable determination that the books and records could be furnished promptly to the Commission is designed to ensure that the ability of the Commission to obtain copies of the books and records would not be diminished. It should also significantly reduce the U.S. registered broker-dealer's cost of recordkeeping with respect to transactions effected pursuant to this exemption. Thus, the Commission believes that allowing U.S. registered broker-dealers to maintain books and records with a foreign broker-dealer would appropriately support the Commission's interest in the protection of investors—by being designed to ensure that the books and records related to transactions for U.S. investors are available to the Commission—while avoiding the burden that might be placed on U.S. registered broker-dealers under the exemption by requiring the books and records to be maintained in the form, manner and for the periods prescribed by Rules 17a–3 and 17a–4 under the Exchange Act,[76] as if the U.S. registered broker-dealer had effected the transactions under proposed Exemption (A)(*1*).

Unlike under the current rule, under Exemption (A)(*1*), the intermediating U.S. registered broker-dealer would not be required to effect all aspects of the transaction.[77] Thus, with respect to transactions effected pursuant to Exemption (A)(*1*), the intermediating U.S. registered broker-dealer would no longer be required to comply with the provisions of the federal securities laws, the rules thereunder and SRO rules applicable to a broker-dealer effecting a transaction in securities, unless it were otherwise involved in effecting the transaction.[78] However, if a foreign broker-dealer effects a transaction pursuant to Exemption (A)(*1*) on a U.S. national securities exchange, through a U.S. alternative trading system, or with a market maker or an over-the-counter dealer in the United States, as is common with respect to U.S. securities, a U.S. registered broker-dealer would be involved in effecting the transaction and would be required to comply with the provisions of the federal securities laws, the rules thereunder and SRO rules applicable to such activity. In other words, such provisions would apply with respect to all transactions in U.S. securities under Exemption (A)(*1*) other than certain over-the-counter transactions that a foreign broker-dealer does not effect by or through a U.S. registered broker-dealer.

The intermediating U.S. registered broker-dealer also would no longer be required to extend or arrange for the extension of credit, issue confirmations and account statements, comply with Rule 15c3–1 with respect to the transactions, or receive, deliver and safeguard funds and securities in connection with the transactions in compliance with Rule 15c3–3.[79] In addition, the intermediating U.S. registered broker-dealer would no longer be required to maintain accounts for the customers of foreign broker-dealers relying on Exemption (A)(*1*),[80] or comply with the requirements applicable to broker-dealers that maintain such accounts. As a result, among other requirements, the U.S. registered broker-dealer may not have obligations under Exchange Act Rule 17a–8 [81] with respect to customers of foreign broker-dealers relying on Exemption (A)(*1*). Rule 17a–8 requires a

[69] *See* Part III.D.1.a.ii., *infra*, for discussion of ''foreign business.''

[70] As mentioned above and discussed more fully below, only foreign broker-dealers that conduct a ''foreign business ''would be eligible to effect transactions on behalf of qualified investors pursuant to Exemption (A)(*1*).

[71] *See* proposed Rule 15a–6(a)(3)(iii)(A)(*1*). Of course, this would not prevent the U.S. registered broker-dealer from performing other aspects of the transaction.

[72] 15 U.S.C. 78c(a)(50).

[73] *See* proposed Rule 15a–6(a)(3)(iii)(A)(*1*). Of course, this would not change any books and recordkeeping obligations a U.S. registered broker-dealer may have under Exchange Act Rules 17a–3 and 17a–4 (17 CFR 240.17a–3 and 17a–4).

[74] 15 U.S.C. 78c(a)(50).

[75] *See* Exchange Act Release No. 44992 (Oct. 26, 2001), 66 FR 55818, 55825 & n.72 (Nov. 2, 2001) (''Generally, requests for records which are readily available at the office (either on-site or electronically) should be filled on the day the request is made. If a request is unusually large or complex, then the firm should discuss with the regulator a mutually agreeable time-frame for production. * * * Valid reasons for delays in producing the requested records do not include the need to send the records to the firm's compliance office for review prior to providing the records.'').

[76] *See* 17 CFR 240.17a–3 and 17a–4.

[77] *See* 17 CFR 240.15a–6(a)(3)(iii)(A) (requiring the U.S. registered broker-dealer to effect all aspects of a transaction other than negotiation of its terms) and proposed Rule 15a–6(a)(3)(iii)(A)(*1*); *see also* note 28, *supra*, for a discussion of the differing treatment of U.S. and foreign securities under current Rule 15a–6(a)(3)(iii)(A)(*1*).

[78] *See* note 28, *supra*, for a discussion of the differing treatment of U.S. and foreign securities under current Rule 15a–6(a)(3)(iii)(A)(*1*).

[79] *See* 17 CFR 240.15a–6(a)(3)(iii)(A)(*1*), (*2*), (*3*), (*4*) and (*5*) and the discussion in Part II.C., *supra*.

[80] *See* text accompanying note 38, *supra*.

[81] 17 CFR 240.17a–8.

U.S. registered broker-dealer to comply with the reporting, recordkeeping and record retention requirements in regulations implemented under the Bank Secrecy Act.[82] As discussed above, current Rule 15a–6 permits an unregistered foreign broker-dealer to effect transactions directly with U.S. persons on an unsolicited basis,[83] and to solicit certain U.S. institutional investors by means of research reports and effect transactions in securities discussed in such reports, subject to certain conditions,[84] in either case without intermediation by a U.S. registered broker-dealer subject to Rule 17a–8. Would permitting a foreign broker-dealer to effect securities transactions on a solicited basis with certain U.S. persons under proposed Exemption (A)(*1*) present any concerns with respect to Rule 17a–8 or anti-money laundering obligations under the Bank Secrecy Act? How should these concerns, if any, be addressed? For example, are there specific circumstances in which the Commission should consider imposing additional obligations on the U.S. registered broker-dealer or the foreign broker-dealer under proposed Exemption (A)(*1*) or alternatively prohibiting the use of Exemption (A)(*1*)?

The Commission requests comment generally on the proposed requirements in Exemption (A)(*1*) of the proposed rule. In particular, the Commission requests comment on whether the Commission should require the U.S. registered broker-dealer to comply with any requirements with respect to transactions under Exemption (A)(*1*) other than the proposed requirement to maintain books and records relating to the transactions. Should the requirements differ based on whether the securities are U.S. securities or foreign securities? If so, why and how? The Commission also requests comment on whether the Commission should require the U.S. registered broker-dealer to maintain books and records relating to the transactions in the form, manner and for the periods prescribed by Rules 17a–3 and 17a–4 under the Exchange Act as if the U.S. registered broker-dealer had effected the transactions under Exemption (A)(*1*). In addition, the Commission requests comment on whether the Commission should permit the U.S. registered broker-dealers to maintain copies of books and records resulting from transactions under paragraph Exemption (A)(*1*) with the foreign broker-dealer. Should it depend on the adequacy of the books and recordkeeping requirements to which the foreign broker-dealer is subject? Should the Commission provide more guidance on or should the proposed rule provide parameters for what would constitute a reasonable determination? In lieu of the proposed requirement of a reasonable determination by the U.S. registered broker-dealer under Exemption (A)(*1*), should the Commission condition the exemption on the foreign broker-dealer filing a written undertaking with the Commission to furnish the books and records to the U.S. registered broker-dealer or the Commission upon request?

Furthermore, the Commission requests comment on whether the requirement under Exemption (A)(*1*) that the U.S. registered broker-dealer make a reasonable determination that books and records relating to any resulting transactions could be furnished promptly to the Commission upon request, and promptly provide such books and records to the Commission upon request, is the appropriate standard given the potential time-zone differences and the fact that such records may be maintained in paper form. If not, what is the appropriate standard and why?

ii. Role of the Foreign Broker-Dealer

The proposed rule would limit the availability of Exemption (A)(*1*) to foreign broker-dealers that are regulated for conducting securities activities (such as effecting transactions in securities), including the specific activities in which the foreign broker-dealer engages with the qualified investor, in a foreign country by a foreign securities authority.[85] This requirement is designed to ensure that only foreign entities that are legitimately in the business of conducting securities activities (such as effecting transactions in securities), and that are regulated in the conduct of those activities, could rely on Exemption (A)(*1*).

Both Exemption (A)(*1*) and Exemption (A)(*2*) would require the foreign broker-dealer to disclose to the qualified investor that it is regulated by a foreign securities authority and not by the Commission. Unlike under Exemption (A)(*2*), for the reasons discussed below,[86] the foreign broker-dealer operating under proposed Exemption (A)(1) would also be required to disclose that U.S. segregation requirements (*e.g.*, the requirement that customer funds and assets be segregated from the broker-dealer's own proprietary funds and assets), U.S. bankruptcy protections (*e.g.*, preference to creditors in bankruptcy) and protections under the Securities Investor Protection Act (''SIPA'')[87] will not apply to any funds and securities of the qualified investor held by the foreign broker-dealer.[88]

These disclosure requirements are intended to help to put qualified investors on notice that foreign broker-dealers operating pursuant to Exemption (A)*(1)* of the proposed rule would not be subject to the same regulatory requirements as U.S. registered broker-dealers. This notice would be important because the proposed rule would eliminate the current chaperoning requirements, as described below, and allow a foreign broker-dealer to effect transactions on behalf of qualified investors and custody qualified investor funds and securities relating to any resulting transactions with more limited participation in the transactions by a U.S. registered broker-dealer. This should be sufficient notice given the level of sophistication of the investors with which the foreign broker-dealer would be engaging in transactions under Exemption (A)*(1)*. Specifically, proposing to require disclosure that the foreign broker-dealer is regulated by a foreign securities authority and not the Commission should alert qualified investors that the foreign broker-dealer would not be subject to the full scope of the Commission's broker-dealer regulatory framework. Proposing to require disclosure that U.S. segregation requirements, U.S. bankruptcy protection and protections under the SIPA would not apply to the funds and securities of the qualified investor held by the foreign broker-dealer should alert the qualified investor that its funds and assets would not receive the same protections that they would under U.S. law.

Exemption (A)*(1)* would only be available to foreign broker-dealers that

[82] Currency and Foreign Transactions Reporting Act of 1970 (commonly referred to as the Bank Secrecy Act). *See* 31 U.S.C. 5311 et seq., 12 U.S.C. 1829b and 12 U.S.C. 1951–1959. The Secretary of the U.S. Department of Treasury has delegated responsibility for the administration of the Bank Secrecy Act to the Director of the Financial Crimes Enforcement Network (''FinCEN''), a bureau of the U.S. Department of Treasury. *See* Treasury Order 180–01 (Sep. 26, 2002).

[83] *See* Part II.A., *supra*.

[84] *See* Part II.B., *supra*.

[85] *See* proposed Rule 15a–6(b)(2)(i).

[86] *See* Part III.D.b.ii., *infra*.

[87] 15 U.S.C. 78aaa *et seq.* The SIPA created the Securities Investor Protection Corporation (''SIPC''), a nonprofit, private membership corporation to which most registered brokers and dealers are required to belong, and established a fund administered by SIPC designed to protect the customers of brokers or dealers subject to the Act from loss in case of financial failure of the member.

[88] *See* proposed Rule 15a–6(a)(3)(i)(D)(1) and (2).

conduct a ''foreign business.'' [89] As explained below, the proposed rule would define ''foreign business'' to mean the business of a foreign broker-dealer with qualified investors and foreign resident clients [90] where at least 85% of the aggregate value of the securities purchased or sold in transactions conducted pursuant to both paragraphs (a)(3) and (a)(4)(vi) of the proposed rule by the foreign broker-dealer, calculated on a rolling two-year basis, is derived from transactions in foreign securities, as defined below.[91] In general, the Commission believes that making Exemption (A)*(1)* available only to a foreign broker-dealer conducting a foreign business would provide U.S. investors increased access to foreign securities and markets without creating opportunities for regulatory arbitrage vis-á-vis U.S. securities markets because the foreign broker-dealer's business in U.S. securities would be limited.

The proposed definition of foreign securities would include both debt and equity securities of foreign private issuers and debt securities of issuers organized or incorporated in the United States but where the distribution is wholly outside the United States in compliance with Regulation S, as well as certain securities issued by foreign governments. The proposed definition is not restricted to certain types of securities, rather, to the extent that qualified investors are interested in purchasing foreign securities, the Commission believes that they should be able to access a broad range of foreign securities. The proposed rule would define ''foreign securities'' to mean:

(i) An equity security (as defined in 17 CFR 230.405) of a foreign private issuer (as defined in 17 CFR 230.405); [92]

(ii) A debt security (as defined in 17 CFR 230.902) of a foreign private issuer (as defined in 17 CFR 230.405);

(iii) A debt security (as defined in 17 CFR 230.902) issued by an issuer organized or incorporated in the United States in connection with a distribution conducted solely outside the United States pursuant to Regulation S (17 CFR 230.903 *et seq.*); [93]

(iv) A security that is a note, bond, debenture or evidence of indebtedness issued or guaranteed by a foreign government (as defined in 17 CFR 230.405) that is eligible to be registered with the Commission under Schedule B of the Securities Act; and

(v) A derivative instrument on a security described in subparagraph (i), (ii), (iii), or (iv) of this paragraph.[94]

The proposed rule would require the foreign broker-dealer to compute the absolute value of all transactions pursuant to both paragraphs (a)(3) and (a)(4)(vi) of the proposed rule (*i.e.*, without netting the transactions) each year to determine the aggregate amount for the previous two years. For example, a foreign broker-dealer that sold 100 shares of Security A at $10.00 per share and bought 100 shares of Security A at $10.00 per share pursuant to paragraphs (a)(3) and (a)(4)(vi) of the proposed rule would have an aggregate value of securities bought and sold of $2000.00 (or (100 × $10.00) + (100 × $10.00)).

We note that the definition of foreign security would include, among other things, derivative instruments on debt and equity securities of foreign private issuers. Given that the proposed rule would provide an exemption for foreign broker-dealers that effect transactions in securities, the proposed definition of ''foreign securities'' would not include derivative instruments that are not themselves securities. Thus, foreign broker-dealers would not need to include the value of swap agreements that meet the definition of ''swap agreement'' in Section 206A of the Gramm-Leach-Bliley Act (''GLBA'') in the foreign business test calculation because they are excluded from the definition of security.[95] In the case of other derivative instruments that are securities, the valuation would depend on the product. For example, the value of options on a security or group or index of securities bought or sold would be the premium paid by the buyer, not the value of the underlying security or securities. Similarly, the value of a security future would be the price times the number of securities to be delivered at the time the transaction is entered into.

Foreign broker-dealers should be able to use this valuation information to calculate the total, combined value of the securities purchased or sold in transactions conducted pursuant to both paragraphs (a)(3) and (a)(4)(vi) of the proposed rule to determine the percentage of foreign securities bought from, or sold to, U.S. investors.

The calculation of the composition of the foreign broker-dealer's business on a rolling, two-year basis would mean that, after the first year the foreign broker-dealer relies on the exemption, the foreign broker-dealer would calculate the aggregate value of securities purchased and sold for the prior two years to determine whether it has complied with the foreign business test to be eligible for proposed Exemption (A)(*1*). This proposed requirement would allow for short-term fluctuations that otherwise could cause a foreign broker-dealer to be out of compliance with the exemption on isolated occasions. A foreign broker-dealer would have the flexibility to elect to use a calendar year or the firm's fiscal year for purposes of complying with the foreign business test. In addition, to provide foreign broker-dealers sufficient time to obtain and verify the relevant aggregate value data, the proposed rule would allow foreign broker-dealers to rely on the calculation made for the prior year for the first 60 days of a new year.[96] Hence, a foreign broker-dealer that had a foreign business over years 1 and 2 would be deemed to have a foreign business for the first 60 days of year 4, regardless of the result of the calculation for year 3. We believe that 60 days would be an appropriate ''grace period'' because it would give a foreign broker-dealer time to make the necessary calculation and to cease relying on Exemption (A)(*1*) if the calculation revealed that it was no longer conducting a foreign business.

Making Exemption (A)(*1*) available only to a foreign broker-dealer

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[89] *See* proposed Rule 15a–6(b)(2)(ii).

[90] *See* Part III.E., *infra.*

[91] *See* proposed Rule 15a–6(b)(3).

[92] 17 CFR 230.405 defines ''foreign private issuer'' to mean any foreign issuer other than a foreign government, except issuers that meet the following conditions: (1) More than 50 percent of the outstanding voting securities of such issuer directly or indirectly owned of record by residents of the United States; and (2) any of the following: (i) the majority of the executive officers or directors are U.S. citizens or residents; (ii) more than 50 percent of the assets of the issuer are located in the United States; or (iii) the business of the issuer is administered principally in the United States. The rule sets forth guidelines for determining the percentage of outstanding voting securities owned of record by residents of the United States.

[93] Thus, debt securities of an issuer organized or incorporated under the laws of the United States would not qualify as ''foreign securities'' if they were offered and sold as part of a global offering involving both an offer and sale of the securities in the United States and a contemporaneous distribution outside the United States. This would be consistent with the purpose of the foreign business test, as discussed below.

[94] *See* proposed Rule 15a–6(b)(5).

[95] The GLBA defines ''swap agreement,'' in part, as an agreement between eligible contract participants (as defined in Section 1a(12) of the Commodity Exchange Act), the material terms of which (other than price and quantity) are subject to individual negotiation. Swap agreements may be based on a wide range of financial and economic interests. Section 206B of the GLBA defines ''security-based swap agreement'' as a swap agreement of which ''a material term is based on the price, yield, value, or volatility of any security or any group or index of securities, or any interest therein.'' Section 3A of the Exchange Act excludes from the definition of security both security-based swap agreements and ''non-security-based swap agreements.'' The Commission retains, however, antifraud authority (including authority over insider trading) over security-based swap agreements. *See, e.g.,* Section 10(b) of the Exchange Act.

[96] *See* proposed Rule 15a–6(b)(3).

conducting a foreign business would provide U.S. investors increased access to foreign securities and foreign markets without creating opportunities for regulatory arbitrage vis-á-vis U.S. securities markets because the foreign broker-dealer's business in U.S. securities would be limited. We believe this is particularly important because, under Exemption (A)(*1*), for the first time, a foreign broker-dealer would be able to provide full-service brokerage services (including maintaining custody of funds and securities from resulting transactions) to certain U.S. investors.

We are proposing an 85% percent threshold for determining whether a foreign broker-dealer conducts a foreign business because we understand from industry representatives that foreign broker-dealers currently effect transactions pursuant to paragraph (a)(3) of Rule 15a–6 primarily in foreign securities and only do a small percentage of business in U.S. securities (less than 10%, by most estimates). The Commission has not been given any indication that foreign broker-dealers would seek to use an expanded exemption to increase their business in U.S. securities. The 85% threshold should accommodate existing business models and allow foreign broker-dealers to continue to do a limited amount of business in U.S. securities, whether as an accommodation to their clients or as part of program trading (*i.e.*, any trading strategy involving the related purchase or sale of a group of stocks as part of a coordinated trading strategy, which could include U.S. securities), without causing those foreign broker-dealers to lose the benefit of the exemption. Any lower threshold could allow a foreign broker-dealer to conduct significant business in U.S. securities with certain U.S. investors without being subject to the full scope of the Commission's broker-dealer regulatory framework. This, in turn, could hinder the ability of the Commission to protect investors, maintain fair, orderly and efficient markets and facilitate capital formation,[97] as well as affect the competitive positions of U.S. registered broker-dealers and foreign broker-dealers.[98]

The Commission seeks comment on proposed Exemption (A)(*1*) generally. We invite comment on the proposed limitation of foreign broker-dealers to those that are regulated for conducting securities activities by a foreign securities authority and that conduct a foreign business. The Commission also seeks comment on whether the proposed disclosures provide appropriate notice to qualified investors that foreign broker-dealers would not be subject to the same regulatory requirements as U.S. registered broker-dealers. Would notice be sufficient? Are there other disclosures that should be required, in particular if the foreign jurisdiction does not require the segregation of qualified investor funds and assets or provide for bankruptcy protection for those funds and assets? Should the foreign broker-dealer be required to identify the foreign securities authority or authorities regulating the foreign broker-dealer? Should disclosure of the applicable dispute resolution system be required? In addition, the Commission requests comment regarding the proposed required form of these disclosures. Should the proposed disclosures be eliminated or modified in any way? If so, how and why?

The Commission solicits comment on the proposed definition of foreign broker-dealer. Should the proposed rule require a foreign broker-dealer to be regulated for conducting securities activities, including the specific activities in which the foreign broker or dealer engages with the qualified investor, in a foreign country by a foreign securities authority? What if foreign securities authorities do not apply their regulations to the activities of their broker-dealers outside their country or with non-residents? The Commission also seeks comment on the proposed definition of foreign securities.[99] Are there any other types of securities that should be included within the definition? Should any types of securities be excluded? Will reference to the equity and debt securities of a ''foreign private issuer,'' as that term is defined in 17 CFR 230.405, affect the interest of foreign issuers to cross-list on both foreign and U.S. exchanges? If so, how? Furthermore, will reference to the equity and debt securities of a ''foreign private issuer,'' as that term is defined in 17 CFR 230.405, affect listings of American Depositary Receipts issued by depositaries against the deposit of the securities of foreign issuers on U.S. exchanges? If so, how?

The Commission seeks comment on the proposed definition of ''foreign business.'' [100] Would the proposed test be workable? Would it be relatively easy for foreign broker-dealers to make the foreign business test calculation? Should the proposed test apply separately to debt and equity securities? Should the proposed test exclude U.S. government securities from the percentage of business in U.S. securities for purposes of computing the threshold? Is the proposed method of valuing options and security futures appropriate? Should we provide examples of how to value other types of derivative instruments?

The Commission requests comment on whether the proposed 85% threshold would be sufficient to enable foreign broker-dealers to effect transactions in U.S. securities as an accommodation and engage in program trading with qualified investors. Would compliance with the threshold be easily determinable? Should it be raised or lowered to better protect against regulatory arbitrage or to achieve its stated purposes? Commenters suggesting a different threshold or a different method for determining compliance with the threshold should explain why the Commission should choose that threshold or method. Instead of requiring foreign broker-dealers to conduct a ''foreign business,'' should Exemption (A)(*1*) of the proposed rule instead permit foreign broker-dealers to effect transactions in foreign securities and U.S. government securities, with a limited exemption for the purchase of U.S. securities by qualified persons as part of a program trade, provided that the purchase or sale of foreign securities predominates?

b. Exemption (A)(*2*)

Proposed Exemption (A)(*2*) is designed to be used by foreign broker-dealers that would like to solicit transactions from qualified investors that have accounts, and custody their funds and securities, with U.S. registered broker-dealers. Because we expect that qualified investors would likely select a foreign broker-dealer for its knowledge of local markets and/or its ability to execute trades in particular markets, as they would under Exemption (A)(*1*), but the foreign broker-dealer would not be acting as custodian of the funds and securities of the qualified investor (*i.e.,* not acting as a full-service broker), we do not believe it would be necessary for Exemption (A)(*2*) to include certain of the requirements proposed to be included in Exemption (A)(*1*), particularly the proposed requirement that the foreign broker-dealer conduct a foreign business, as described above.

i. Role of the U.S. Registered Broker-Dealer

Under Exemption (A)(*2*), the U.S. registered broker-dealer would be responsible for maintaining books and

[97] *See* Exchange Act Section 2, 15 U.S.C. 78b.

[98] *See* Exchange Act Section 3(f); *see also* Part VI.C., *infra.*

[99] *See* proposed Rule 15a–6(b)(5).

[100] *See* proposed Rule 15a–6(b)(3).

records, including copies of all confirmations issued by the foreign broker-dealer to the qualified investor, relating to any transactions effected under this exemption.[101] This requirement is designed to ensure that the Commission would have access to books and records relating to resulting transactions, as well as copies of confirmations issued by the foreign broker-dealer to the qualified investor. Because the U.S. registered broker-dealer would carry the account of the qualified investor under Exemption (A)(*2*), we understand from discussions with industry representatives that it would be consistent with current business practices for the U.S. registered broker-dealer to maintain the books and records for transactions effected under this exemption.

Proposed Exemption (A)(*2*) would also require the U.S. registered broker-dealer to receive, deliver and safeguard funds and securities in connection with the transactions on behalf of the qualified investor in compliance with Rule 15c3–3 under the Exchange Act.[102] As explained below, Exemption (A)(*2*) is designed to permit qualified investors that have an account with a U.S. registered broker-dealer to have access to foreign broker-dealers regardless of the types of securities that are involved.[103]

Unlike under the current rule, under Exemption (A)(*2*), the intermediating U.S. registered broker-dealer would not be required to effect the transaction.[104] Thus, with respect to transactions effected pursuant to Exemption (A)(*2*), the intermediating U.S. registered broker-dealer would no longer be required to comply with the provisions of the federal securities laws, the rules thereunder and SRO rules applicable to a broker-dealer effecting a transaction in securities, unless it were otherwise involved in effecting the transaction.[105] However, if a foreign broker-dealer effects a transaction pursuant to Exemption (A)(*2*) on a U.S. national securities exchange, through a U.S. alternative trading system, or with a market maker or an over-the-counter dealer in the United States, as is common with respect to U.S. securities, a U.S. registered broker-dealer would be involved in effecting the transaction and would be required to comply with the provisions of the federal securities laws, the rules thereunder and SRO rules applicable to such activity. In other words, such provisions would apply with respect to all transactions in U.S. securities under Exemption (A)(*2*) other than certain over-the-counter transactions that a foreign broker-dealer does not effect by or through a U.S. registered broker-dealer.

ii. Role of the Foreign Broker-Dealer

A foreign broker-dealer relying on Exemption (A)(*2*) would not be permitted to maintain custody of qualified investor funds and securities relating to any resulting transactions. Because of this limitation, Exemption (A)(*2*) would be available to all foreign broker-dealers and not just those that conduct a foreign business. Because entities that meet the definition of foreign broker-dealer under the proposed rule could not operate full-service brokerage under this exception, we believe that there is less risk of regulatory arbitrage.

Like Exemption (A)(*1*), Exemption (A)(*2*) would only be available to foreign broker-dealers that are regulated for conducting securities activities, including the specific activities in which the foreign broker-dealer engages with the qualified investor, in a foreign country by a foreign securities authority.[106] This requirement is designed to ensure that only foreign entities that are legitimately in the business of conducting securities activities (such as effecting transactions in securities), and that are regulated in the conduct of those activities, could rely on Exemption (A)(*2*). In addition, the foreign broker-dealer relying on Exemption (A)(*2*) would be required to disclose to the qualified investor that the foreign broker-dealer is regulated by a foreign securities authority and not by the Commission. Unlike under Exemption (A)(*1*), however, the foreign broker-dealer relying on Exemption (A)(*2*) would not be required to provide disclosures to the qualified investor regarding segregation requirements, bankruptcy protections and protections under SIPA. The Commission does not believe these disclosures would be necessary given that, under proposed Exemption (A)(*2*), the U.S. registered broker-dealer would be maintaining custody of funds and securities of qualified investors in connection with the resulting transactions.

As noted above, we expect that Exemption (A)(*2*) would be used by qualified investors that would like to access foreign broker-dealers but nonetheless would like to have an account, and maintain custody of their funds and securities, with a U.S. registered broker-dealer. Because a foreign broker-dealer would be selected for its knowledge of local markets and/or its ability to execute trades in particular markets, but would not be acting as custodian of the funds and securities of the qualified investor (*i.e.*, not acting as a full-service broker), we do not believe it would be necessary for proposed Exemption (A)(*2*) to include certain of the requirements contained in proposed Exemption (A)(*1*), particularly the requirement that the foreign broker-dealer conduct a foreign business, as described above.

The Commission requests comment on proposed Exemption (A)(*2*) generally. How would this exemption likely be used and by whom? Should proposed Exemption (A)(*2*) be available when the U.S. registered broker-dealer does not maintain custody of the qualified investor's funds and securities (*e.g.*, when a U.S. or foreign affiliate of the U.S. registered broker-dealer custodies the funds and securities otherwise than pursuant to Rule 15c3–3 under the Exchange Act)?[107]

The Commission also seeks comment on whether the proposed rule should require the U.S. registered broker-dealer to comply with any requirements with respect to transactions under Exemption (A)(*2*) other than the proposed requirement to maintain books and records and maintain custody of qualified investors' funds and securities relating to the transactions. Should the requirements differ based on whether the securities are U.S. securities or foreign securities? If so, why?

In addition, the Commission seeks comment on whether the proposed disclosures would provide appropriate notice to qualified investors that foreign broker-dealers would not be subject to the same regulatory requirements as U.S. registered broker-dealers. Would notice be sufficient? Are there are other

[101] *See* proposed Rule 15a–6(a)(3)(iii)(A)(*2*)(*i*).

[102] 17 CFR 240.15c3–3. *See* proposed Rule 15a–6(a)(3)(iii)(A)(*2*)(*ii*). Securities received and safeguarded under Exemption (A)(*2*) would be securities carried for the account of a customer under Rule 15c3–3(a)(2). 17 CFR 240.15c3–3(a)(2).

[103] Under Exemption (A)(*2*), the foreign broker-dealer would be permitted to clear and settle the transactions on behalf of the U.S. registered broker-dealer. The Commission believes that this is appropriate for transactions effected under Exemption (A)(*2*) for investors that possess the sophistication of qualified investors, particularly given that the exemption would require a U.S. registered broker-dealer to maintain books and records and receive, deliver and safeguard funds and securities in connection with the transactions.

[104] *See* 17 CFR 240.15a–6(a)(3)(iii)(A) (requiring the U.S. registered broker-dealer to effect all aspects of a transaction other than negotiation of its terms) and proposed Rule 15a–6(a)(3)(iii)(A)(*2*); *see also* note 28, *supra*, for a discussion of the differing treatment of U.S. and foreign securities under current Rule 15a–6(a)(3)(iii)(A)(*1*).

[105] *See* note 28, *supra*, for a discussion of the differing treatment of U.S. and foreign securities under current Rule 15a–6(a)(3)(iii)(A)(*1*).

[106] *See* proposed Rule 15a–6(b)(2)(i).

[107] 17 CFR 240.15c3–3.

disclosures that should be required? In particular, should the foreign broker-dealer be required to identify the foreign securities authority or authorities regulating the foreign broker-dealer? Should disclosure of the applicable dispute resolution system be required? In addition, the Commission requests comment regarding the proposed required form of these disclosures. Should the proposed disclosures be eliminated or modified in any way? If so, how and why?

In general, the Commission seeks comment on whether proposed Exemption (A)(*1*) and Exemption (A)(*2*) alternatives would provide a meaningful choice for qualified investors wishing to access foreign broker-dealers. What would be the advantages and disadvantages of using each alternative?

2. Sales Activities

Both proposed Exemption (A)(*1*) and proposed Exemption (A)(*2*) would eliminate the requirements in current Rule 15a–6(a)(3) for foreign associated persons [108] to be accompanied by an associated person of a U.S. registered broker-dealer during in-person visits with U.S. investors. The proposed rule also would eliminate the current requirement for an associated person of a U.S. registered broker-dealer to participate in communications between foreign associated persons and U.S. investors, whether oral or electronic.

From discussions with industry representatives, the staff understands that the current chaperoning requirements have been criticized as impractical and that they have been viewed as imposing unnecessary operational and compliance burdens particularly for communications with broker-dealers in time zones outside those of the United States. The current rule allows some unchaperoned contacts, in part due to the existence of other provisions of the rule that require review of ''the background of, foreign personnel who will contact U.S. institutional investors.'' [109] The proposed amendments would retain the requirement that the background of foreign personnel be reviewed, albeit by the foreign broker-dealer,[110] but would expand the ability of foreign broker-dealers to have unchaperoned contacts. Specifically, the proposed rule would not limit a foreign broker-dealer's ability to have unchaperoned communications, both oral and electronic, with qualified investors, as part of a transaction pursuant to either exemption in paragraph (a)(3) of the proposed rule. In addition, the proposed rule would provide that a foreign associated person may conduct unchaperoned visits to qualified investors within the United States, provided that transactions in any securities discussed during visits by the foreign associated person with qualified investors are effected pursuant to either exemption in paragraph (a)(3) of the proposed rule because these transactions would be viewed as being solicited.[111] The Commission believes that increasing the ability of foreign broker-dealers to have unchaperoned contacts should provide greater flexibility for both investors and industry participants in conducting communications and that eliminating the requirement to have a U.S. registered broker-dealer present for such communications should not result in any significant loss of safeguards for qualified investors because of the sophistication and experience standards in the definition of qualified investor and the proposed disclosure requirements in Exemption (A)(*1*) and Exemption (A)(*2*).

As noted above, the proposed rule would allow a foreign broker-dealer to have unchaperoned visits within the United States. Whether a foreign associated person's stay in the United States would qualify as a ''visit'' for purposes of the proposed rule would be a facts and circumstances determination based on factors including, but not limited to, the purpose, length and frequency of any stays. The Commission proposes to interpret a ''visit'' as one or more trips to the United States over a calendar year that do not last more than 180 days in the aggregate. The purpose of this proposed limitation regarding visits is to prevent foreign broker-dealers from essentially having a permanent sales force in the United States, which may result in foreign broker-dealers essentially conducting a U.S. based business, similar to U.S. registered broker-dealers, without appropriate regulatory oversight of these foreign broker-dealers. We preliminarily believe that 180 days strikes the proper balance between facilitating legitimate foreign broker-dealer activity in the United States, such as investment banking, and the potential competitive issues with U.S. registered broker-dealers and investor protection concerns.

The Commission requests comment on its proposed interpretation of what would constitute a visit. Should the Commission provide a bright-line definition of what constitutes a ''visit'' or is a more flexible approach appropriate? Is it appropriate to interpret ''visit'' as a specific number of days in a calendar year that a foreign broker-dealer could be in the United States? If so, is 180 days a calendar year appropriate? Or would a lower number such as 120, 90, 60, or 30 days a calendar year be more appropriate? We also solicit comment on the factors for determining what qualifies as a ''visit,'' described above. In addition, the Commission requests comment on eliminating the chaperoning requirements of the current rule. Are unchaperoned contacts between foreign broker-dealers and their associated persons and qualified investors appropriate?

3. Establishment of Qualification Standards

Foreign broker-dealers intending to rely on proposed Rule 15a–6(a)(3) would need to meet certain qualification requirements.[112] As under the current rule, the foreign broker-dealer would be required to provide the Commission, upon request or pursuant to agreement between the Commission or the United States and any foreign securities authority, information or documents related to the foreign broker-dealer's activities in inducing or attempting to induce securities transactions by qualified investors.[113] This information would permit the Commission to monitor and follow up on transactional activity conducted under Rule 15a–6, as necessary and appropriate.

The proposed rule also would require the foreign broker-dealer to determine that its associated persons that effect transactions with qualified investors are not subject to a statutory disqualification under Section 3(a)(39) of the Exchange Act.[114] This would be a change from the current rule, which requires the U.S. registered broker-dealer intermediating the transaction to make this determination.[115] Specifically, current Rule 15a–6(a)(3)(ii)(B) requires a U.S. registered broker-dealer to determine that the foreign associated persons of a foreign broker-dealer effecting transactions with U.S. institutional investors or major U.S. institutional investors are not subject to

[108] The proposed rule would retain the definition of ''foreign associated person'' that is in paragraph (b)(2) of the current Rule 15a–6, but would substitute ''qualified investor'' for ''U.S. institutional investor or major U.S. institutional investor'' in the definition. *See* proposed Rule 15a–6(b)(1).

[109] *See* 1988 Proposing Release, 53 FR at 23653.

[110] *See* Proposed Rule 15a–6(a)(3)(i)(B) and (C).

[111] *See* proposed Rule 15a–6(a)(3)(ii).

[112] *See* proposed Rule 15a–6(a)(3)(i).

[113] *See* proposed Rule 15a–6(a)(3)(i)(A) and 17 CFR 240.15a–6(a)(3)(i)(B).

[114] *See* proposed Rule 15a–6(a)(3)(i)(B).

[115] *See* 17 CFR 240.15a–6(a)(3)(ii)(B).

a statutory disqualification specified in Section 3(a)(39) of the Exchange Act, or certain substantially equivalent foreign disciplinary actions. Because of subsequent legislation, the proposed rule would no longer separately describe the foreign equivalents of statutory disqualification.[116] The Commission believes shifting the responsibility for making the statutory disqualification determination would be appropriate because the foreign broker-dealer is in possession of the relevant information regarding its foreign associated persons. Thus, we believe, as a practical matter, foreign broker-dealers are already making this determination so that U.S. registered broker-dealers can comply with their obligations under the existing rule. As discussed below, the proposed rule would require the U.S. registered broker-dealer to obtain a representation from the foreign broker-dealer that it has made this determination.

Under the current rule, a U.S. registered broker-dealer must obtain, with respect to each foreign associated person, information specified in Rule 17a–3(a)(12) under the Exchange Act[117] that relates to activities under paragraph (a)(3).[118] The proposed rule would require the foreign broker-dealer to maintain this information in its files and make it available upon request by the U.S. registered broker-dealer or the Commission.[119] This information would include 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.[120]

The proposed rule would provide that the information kept by the foreign broker-dealer as specified in Rule 17a–3(a)(12)(i)(D)[121] must include documentation of sanctions imposed by foreign securities authorities, foreign exchanges, or foreign associations, including without limitation those described in Section 3(a)(39) of the Exchange Act.[122] The Commission believes shifting the responsibility would be appropriate because the foreign broker-dealer is in possession of the relevant information regarding its foreign associated persons. Thus, we believe, as a practical matter, foreign broker-dealers are already making this determination so that U.S. registered broker-dealers can comply with their obligations under the existing rule. As discussed below, the proposed rule would require the U.S. registered broker-dealer to obtain a representation from the foreign broker-dealer that it is maintaining the required information.

Consistent with the current rule, proposed Rule 15a–6(a)(3) would require the U.S. registered broker-dealer to obtain from the foreign broker-dealer and each foreign associated person written consent to service of process for any civil action brought by or proceeding before the Commission or a self-regulatory organization (as defined in Section 3(a)(26) of the Exchange Act).[123] The U.S. registered broker-dealer would also be responsible for obtaining from the foreign broker-dealer a representation that the foreign broker-dealer has determined that any foreign associated person of the foreign broker-dealer effecting transactions with the qualified investor is not subject to a statutory disqualification specified in Section 3(a)(39) of the Act, as required by paragraph (a)(3)(i)(B) of the proposed rule and discussed above.[124]

In addition, the U.S. registered broker-dealer would be responsible for obtaining from the foreign broker-dealer a representation that it has in its files, and the foreign broker-dealer would make available upon request by the U.S. registered broker-dealer or the Commission, the types of information specified in Rule 17a–3(a)(12) under the Act, as required by paragraph (a)(3)(i)(C) of the proposed rule and discussed above.[125] Finally, the proposed rule would require the U.S. registered broker-dealer to maintain records of these written consents and representations and, as in the current rule, make these records available to the Commission upon request.[126] These proposed requirements are important because they are designed to ensure that the Commission would be able to obtain information regarding foreign associated persons if it were necessary in the context of an investigation into alleged misconduct by a foreign broker-dealer or persons associated with the foreign broker-dealer. The Commission believes that allowing U.S. registered broker-dealers to rely upon the determinations and representations of foreign broker-dealers discussed above is a balanced approach that should address the risks

[116] At the time the Commission adopted Rule 15a–6, the definition of ''statutory disqualification'' in Section 3(a)(39) did not include expulsions, suspensions or other orders under foreign statutes or foreign equivalents of U.S. regulatory authorities. The International Securities Enforcement Cooperation Act of 1990 amended Section 3(a)(39) to include certain foreign conduct and disciplinary action in the definition of ''statutory disqualification'', including each type of conduct or disciplinary action described in paragraphs (a)(3)(ii)(B)(*1*)(*i*)–(*v*), (a)(3)(ii)(B)(*2*) and (a)(*3*)(ii)(B)(*3*) of Rule 15a–6. *See* Pub. L. 101–550, 104 Stat. 2714 (1990).

[117] 17 CFR 240.17a–3(a)(12).

[118] *See* 17 CFR 240.15a–6(a)(3)(iii)(C).

[119] *See* Proposed Rule 15a–6(a)(3)(i)(C).

[120] 17 CFR 240.17a–3(a)(12).

[121] 17 CFR 240.17a–3(a)(12)(i)(D) (requiring a broker-dealer to make and keep current a record of any denial of membership or registration, and of any disciplinary action taken, or sanction imposed, upon the associated person by any federal or state agency, or by any national securities exchange or national securities association, including any finding that the associated person was a cause of any disciplinary action or had violated any law).

[122] *See* proposed Rule 15a–6(a)(3)(i)(C).

[123] *See* proposed Rule 15a–6(a)(3)(iii)(B) and 17 CFR 240.15a–6(a)(3)(iii)(C). As in the current rule, the consent would be required to provide that process may be served on them by service on the registered broker-dealer in the manner set forth on the registered broker's or dealer's current Form BD. This would put individuals on notice of the manner in which process would be served.

[124] *See* proposed Rule 15a–6(a)(3)(iii)(C).

[125] *See id.*

[126] *See* proposed Rule 15a–6(a)(3)(i)(D). The provisions of proposed Rules 15a–6(a)(3)(iii)(B) and (D) are similar to paragraphs (a)(3)(iii)(D) and (E) of the current rule, although the proposed rule would eliminate the requirement under current Rule 15a–6(a)(3)(iii)(E) that the registered broker-dealer maintain a written record of all records in connection with trading activities of the qualified investor involving the foreign broker-dealer. This requirement is subsumed in other sections of the proposed rule. *See* proposed Rule 15a–6(a)(3)(iii)(A)–(D).

to qualified investors related to, among other things, contacts with foreign associated persons with a disciplinary history.

The Commission seeks comment on the qualification standards that would apply to foreign broker-dealers and U.S. registered broker-dealers under the proposed rule. Commenters are invited to discuss whether reliance by a U.S. registered broker-dealer upon the determinations and representations of a foreign broker-dealer appropriately addresses the potential risks to qualified investors related to, among other things, contacts with foreign associated persons with a disciplinary history. Should any of the responsibilities for making the statutory disqualification determinations or obtaining consents be shifted? Should the proposed rule require that the foreign broker-dealer (or the U.S. registered broker-dealer) determine whether the foreign associated persons are subject to statutory disqualifications?

E. Counterparties and Specific Customers

As in the current rule, proposed Rule 15a–6(a)(4) would provide exemptions for foreign broker-dealers that effect transactions in securities with or for, or induce or attempt to induce the purchase or sale of any security, by certain persons, including registered broker-dealers, certain international banks and bank organizations, certain foreign persons temporarily present in the United States and certain U.S. persons or groups of U.S. persons abroad. We understand from discussions with industry that these exemptions have been workable for both foreign broker-dealers and the U.S. entities and we have no knowledge of investor protection concerns being raised. Accordingly, we do not propose to amend them.

We do, however, propose to provide an additional exemption for transactions with U.S. resident fiduciaries of accounts for ''foreign resident clients'' because it is our understanding that foreign resident clients would not assume that the broker-dealer through which a U.S. resident fiduciary is effecting transactions is regulated by the Commission.[127] The proposed rule would define ''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 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 subparagraphs (i) and (ii) of this paragraph.'' [128] Discussions with industry have indicated that these are the types of entities that would likely use the proposed exemption. We selected the 85 percent threshold to capture foreign entities that are predominantly foreign-owned, while accommodating a small amount of U.S. ownership.[129]

For purposes of both the broker-dealer registration provisions of the Exchange Act and the proposed exemption provided by Rule 15a–6(a)(4)(vi), a U.S. resident fiduciary is considered to be a U.S. person, regardless of the residence of the owners of the underlying accounts. Accordingly, absent an exemption, a foreign broker-dealer that induces or attempts to induce a securities transaction with a U.S. resident fiduciary would be required either to register with the Commission or effect transactions in accordance with Rule 15a–6(a)(3). We understand, however, that foreign resident clients of a U.S. resident fiduciary reasonably may not expect the U.S. broker-dealer regulatory requirements to apply to their transactions in foreign securities, in large part simply because the transactions are in foreign securities.

Accordingly, the proposed rule would permit a foreign broker-dealer to effect transactions in, or induce or attempt to induce the purchase or sale of, securities, with or for 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,'' [130] that acts in a fiduciary capacity for an account of a foreign resident client. Consistent with our understanding of the expectations of foreign resident clients of a U.S. resident fiduciary, this proposed exemption would be available only to a foreign broker-dealer that conducts a foreign business.[131] As indicated above, this exemption would recognize that foreign resident clients would not expect that the broker-dealer through which a U.S. resident fiduciary is effecting transactions is regulated by the Commission. Moreover, under the proposed rule, the foreign broker-dealer would be required to obtain a written representation from the U.S. fiduciary that the account is managed in a fiduciary capacity for a foreign resident client.[132] This requirement is designed to ensure that the U.S. fiduciary is actually managing accounts for foreign resident clients.

The Commission seeks comment generally on the exemptions in paragraph (a)(4) of the proposed rule for transactions with certain U.S. entities. Are there entities or other categories of entities that should be included? The Commission particularly seeks comment on the proposed exemption for transactions with U.S. fiduciaries of accounts for foreign resident clients. Is the requirement that a foreign broker-dealer conduct a foreign business necessary or appropriate? Should the rule apply to U.S. fiduciaries for accounts other than those of foreign resident clients? The Commission requests comment on the definition of ''foreign resident client,'' in general, and the 85 percent foreign ownership threshold for entities not organized or incorporated under the laws of the United States, in particular. Should it be raised or lowered to better protect against regulatory arbitrage or to achieve its stated purposes? Commenters suggesting a different threshold or a different method for determining compliance with the threshold should explain why they would choose that threshold or method.

F. Familiarization With Foreign Options Exchanges

Over the years, foreign options exchanges have inquired regarding the

[127] *Cf.* Letter from Catherine McGuire, Chief Counsel, Division of Market Regulation, to Giovanni P. Prezioso, Cleary Gottlieb, Steen & Hamilton (Jan. 30, 1996).

[128] *See* proposed Rule 15a–6(b)(4).

[129] The Commission considers a person to be a control person if he or she directly or indirectly has the power to vote 25 percent or more of the voting securities or interests of an entity. *See, e.g.*, 17 CFR 240.12b–2. The concept of control, which is found in all the statutes administered by the Commission, varies to some degree between statutes. Although the Exchange Act does not define ''control,'' Rule 12b–2 under the Exchange Act defines ''control'' as ''the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise.'' This definition has been found to apply to all Exchange Act control determinations. *In re Commonwealth Oil / Tesoro Petroleum Securities Litigation*, 484 F. Supp. 253, 268 (W.D. Tex. 1979) (the right to vote 25 percent or more of the voting securities or is entitled to 25 percent or more of the profits is presumed to control that company). The 85 percent threshold in proposed paragraph (b)(4)(iii) is designed to ensure that entities with U.S. control persons would not meet the proposed definition of ''foreign resident client.''

[130] *See* Sections 3(a)(4)(B), 3(a)(4)(E) and 3(a)(5)(C) of the Exchange Act. Foreign broker-dealers that want to effect transactions for registered broker-dealers or banks acting pursuant to certain exceptions or exemptions from the definition of ''broker'' or ''dealer'' can do so under the exemption in paragraph (a)(4)(i) of Rule 15a–6. *See* 17 CFR 240.15a–6(a)(4)(i).

[131] *See* proposed Rule 15a–6(b)(2)(ii).

[132] *See* proposed Rule 15a–6(a)(4)(vi)(B).

permissibility of limited activities designed to familiarize U.S. entities that have had prior actual experience with traded options in U.S. options markets, such as U.S. registered broker-dealers and certain U.S. institutional investors, with the existence and operations of, and options on foreign securities traded on, such foreign options exchanges. These exchanges have limited the activities conducted by their representatives, who may be located in a foreign office or in a representative office in the United States, and by their foreign broker-dealer members.

1. Exchange Act Section 15(a)

Because the activities by a representative of a foreign options exchange may constitute solicitation,[133] they raise potential registration concerns for foreign broker-dealer participants on the exchanges under Section 15(a).[134] This is in part because the activities are undertaken with the expectation that one or more U.S. registered broker-dealers or U.S. institutional investors will engage in foreign options transactions executed through the exchange, and thus trade through one or more foreign broker-dealer members of the exchange. Similarly, the activities of a foreign broker-dealer member of a foreign options exchange may constitute solicitation under the Commission's broad interpretation of solicitation.

The Commission recognizes the role of these activities in making certain U.S. investors aware of foreign options markets and the options on foreign securities traded on those markets. Accordingly, the Commission is proposing a new exemption to provide legal certainty for the foreign broker-dealer members and these foreign options exchanges. Paragraph (a)(5) of proposed Rule 15a–6 would allow a foreign broker-dealer that is a member of a foreign options exchange to effect transactions in options on foreign securities listed on that exchange for a qualified investor that has not otherwise been solicited by the foreign broker-dealer.[135] Under this exemption, a foreign broker-dealer, a foreign options exchange and representatives of the foreign options exchange could conduct certain activities or communicate with a qualified investor in a manner that might otherwise be considered a form of solicitation, as described below.[136] Transactions effected by or through the foreign broker-dealer with or for qualified investors that result from these activities or communications would not require registration or compliance with proposed Rule 15a–6(a)(3). However, while these activities would not necessarily constitute a form of solicitation, the Commission anticipates that given the broad interpretation of solicitation, it would be difficult, if not impractical, to conduct repeated transactions with the same qualified investor without the foreign broker-dealer engaging in some form of communication that would constitute solicitation. Therefore, the Commission anticipates that most transactions with qualified investors resulting from these activities or communications would need to be completed pursuant to proposed Rules 15a–6(a)(3).

Paragraph (a)(5)(i) of proposed Rule 15a–6 would set forth the limited activities in which a representative of a foreign options exchange located in a foreign office or a representative office in the United States may engage vis-à-vis qualified investors. The proposed rule would allow the representative of a foreign options exchange to communicate with persons that he or she reasonably believes are qualified investors regarding the foreign options exchange, the options on foreign securities traded on the foreign options exchange, and, if applicable, the foreign options exchange's "OTC options processing service," as defined below.[137] Such communications could include programs and seminars in the United States.

Proposed Rule 15a–6(b)(6) would define an "OTC options processing service" as "a mechanism for submitting an options contract on a foreign security that has been negotiated and completed in an over-the-counter transaction to a foreign options exchange so that the foreign options exchange may replace that contract with an equivalent standardized options contract that is listed on the foreign options exchange and that has the same terms and conditions as the over-the-counter options." By utilizing an OTC options processing service, qualified investors would be able to take advantage of the flexible nature of the OTC options market, while realizing certain efficiencies and benefits available in an exchange-traded market. In particular, qualified investors would have greater opportunities to close out options positions. In a typical OTC options transaction, a party must either negotiate with its counterparty to close out the trade or enter into an offsetting transaction to reduce its risk. In addition, OTC options processing services would provide a means for qualified investors to reduce other risks that arise in trading in the OTC options market, including credit risks, liquidity risks, legal risks and operational risks. By using an OTC options processing service, qualified investors would be able to access the benefits available in the OTC options market while taking advantage of the benefits and decreased risks available in the exchange-traded market.

The proposed rule would also permit a representative of a foreign options exchange to provide persons that the representative of the foreign options exchange reasonably believes are qualified investors with a disclosure document that provides an overview of the foreign options exchange and the options on foreign securities traded on that exchange, including the differences from standardized options in the U.S. options market and special factors relevant to transactions by U.S. entities in options on the foreign options exchange.[138] In addition, a representative of a foreign options exchange could make available to persons that the representative of the foreign options exchange reasonably believes are qualified investors, solely upon the request of the investor, a list of participants on the foreign options exchange permitted to take orders from the public and any U.S. registered broker-dealer affiliates of such participants.[139] Moreover, paragraph (5)(iii) would allow the foreign exchange to make available to qualified investors, through the foreign broker-dealer, the exchange's OTC options processing service.[140]

In proposing to limit these activities, the proposed rule is designed to ensure that a foreign options exchange and its representatives do not engage in solicitation on behalf of a particular foreign broker-dealer or limited group of particular foreign broker-dealers.

Paragraph (a)(5)(ii) of the proposed rule would set forth the activities in which a foreign broker-dealer could engage in connection with transactions effected on a foreign options exchange

[133] For a discussion of the Commission's broad interpretation of solicitation, *see* Parts II.A. and III.B., *supra*.

[134] The fact that the activities are conducted by the exchanges through their representatives does not necessarily eliminate the registration concerns of the participants on those exchanges. *See* Exchange Act Section 20(b), 17 U.S.C. 78t(b) ("It shall be unlawful for any person, directly or indirectly, to do any act or thing which it would be unlawful for such person to do under the provisions of this title or any rule or regulation thereunder through or by means of any other person").

[135] *See* proposed Rule 15a–6(a)(5).

[136] *See* proposed Rules 15a–6(a)(5)(i)–(iii).

[137] *See* proposed Rule 15a–6(a)(5)(i)(A).

[138] *See* proposed Rule 15a–6(a)(5)(i)(B).

[139] *See* proposed Rule 15a–6(a)(5)(i)(C).

[140] *See* proposed Rule 15a–6(a)(5)(iii).

of which it is a member. A foreign broker-dealer would be permitted to make available to qualified investors the foreign options exchange's OTC options processing service.[141] A foreign broker-dealer would also be permitted to provide qualified investors, in response to an otherwise unsolicited inquiry concerning foreign options traded on the foreign options exchange, with a disclosure document that provides an overview of the foreign options exchange and the options on foreign securities traded on that exchange, including the differences from standardized options in the U.S. domestic options market and special factors relevant to transactions by U.S. entities in options on that exchange.[142]

2. Exchange Act Sections 5 and 6

Section 5 of the Exchange Act makes it ''unlawful for any broker, dealer, or exchange, directly or indirectly, to make use of the mails or any means or instrumentality of interstate commerce for the purpose of using any facility of an exchange with or subject to the jurisdiction of the United States to effect any transaction in a security, or to report any such transaction,'' unless such exchange is registered under Section 6 of the Exchange Act or exempt from such registration.[143] As described above, paragraph (a)(5) of proposed Rule 15a–6 would establish the limited activities and communications in which a representative of a foreign options exchange located in a foreign office or a representative office in the United States may engage vis-à-vis qualified investors,[144] and in which a foreign broker-dealer may engage in connection with transactions effected on a foreign options exchange in which it is a member.[145] In addition, a foreign exchange could make available to qualified investors, through a foreign broker-dealer, the exchange's OTC options processing service.[146]

The Commission is proposing to provide interpretive guidance that a foreign exchange would not be required to register as a national securities exchange under Section 6 of the Exchange Act or be exempt from such registration if the foreign exchange, its representatives, or its foreign broker-dealer members engaged in the limited activities and communications described in proposed paragraph (a)(5) of Rule 15a–6. The Commission's proposed interpretation is based on its preliminary view that, although a foreign exchange's OTC options processing service may be a facility of an exchange,[147] the OTC options processing service would not effect any transaction in a security or report any such transaction.[148] Accordingly, such activity would not trigger the registration requirements of Section 6 of the Exchange Act.[149]

The Commission seeks comment on its proposed interpretation that a foreign exchange would not be required to register as a national securities exchange under Section 6 of the Exchange Act if the foreign exchange, its representatives, or its foreign broker-dealer members engage in the limited activities and communications described in paragraph (a)(5) of proposed Rule 15a–6. Are any additional conditions necessary or are there other interpretive issues relating to the circumstances under which a foreign exchange would be required to register under Section 6 of the Exchange Act, or otherwise obtain an exemption from such registration requirements, that the Commission should address?

3. Exchange Act Section 17A

Under proposed Rule 15a–6(a)(5), qualified investors would not become direct members of, or participants in, the foreign options exchange or any associated foreign clearing organization. Further, the foreign options exchange would not trade nor would the foreign clearing organization clear and settle options on U.S. securities for a foreign broker-dealer member or participant relying on proposed paragraph (a)(5) for the transaction. The foreign broker-dealer member or participant would execute transactions in options on foreign securities, or submit an options contract on foreign securities, and the foreign clearing organization would clear and settle these transactions for its foreign broker-dealer participants in the same manner as any other transaction executed on the foreign options exchange.

Section 17A(b)(1) of the Exchange Act prohibits any clearing agency from directly or indirectly making ''use of the mails or any means or instrumentality of interstate commerce to perform the functions of a clearing agency with respect to any security (other than an exempted security),'' unless it is registered with the Commission.[150] The Commission may conditionally or unconditionally exempt any clearing agency if the Commission finds that such exemption is consistent with the public interest, the protection of investors and the purposes of Section 17A.[151]

Previously, the Commission has required foreign clearing organizations to obtain an exemption from clearing agency registration only when the foreign clearing organization provides clearance and settlement services for U.S. securities directly to U.S. entities. For example, the Commission granted Euroclear and Clearstream (formerly Cedel Bank) exemptions from clearing agency registration in order that they could provide clearance and settlement services for U.S. government securities to their U.S. participants.[152] Because only the foreign broker-dealer would have direct access to the foreign clearing organization to clear and settle foreign securities transactions under proposed Rule 15a–6(a)(5), the Commission does not believe that relief under Section 17A of the Exchange Act would be necessary. The Commission solicits comment on whether any interpretive guidance is needed under Section 17A with respect to activities under proposed Rule 15a–6(a)(5). If so, what?

4. Securities Act

Foreign option transactions that are effected through the facilities of a foreign exchange will generally involve the offer and sale of a security by an issuer of the security.[153] As a result,

[141] *See* proposed Rule 15a–6(a)(5)(ii)(A).

[142] *See* proposed Rule 15a–6(a)(5)(ii)(B). Exchange Act Rule 9b–1 requires an options market to file with the Commission an options disclosure document containing the information specified in Rule 19b–1(c). ''Options markets'' are defined in Rule 19b–1 to include foreign securities exchanges. *See* Exchange Act Rule 19b–1(a)(1), 17 CFR 240.19b–1(a)(1). The Commission would not view the provision of the options disclosure document, which contains, among other things, a summary of the instruments traded and the mechanics of trading on that market, as a ''research report'' under proposed Rule 15a–6(a)(2). *See* Parts II.B. and III.C., *supra*.

[143] 15 U.S.C. 78e.

[144] *See* proposed Rule 15a–6(a)(5)(i).

[145] *See* proposed Rule 15a–6(a)(5)(ii).

[146] *See* proposed Rule 15a–6(a)(5)(iii).

[147] *See* Section 3(a)(2) of the Exchange Act, 15 U.S.C. 78c(a)(2) (defining ''facility'' of an exchange).

[148] *See* note 143 and accompanying text, *supra* (discussing Section 5 of the Exchange Act, which prohibits a broker, dealer, or exchange from using a facility of an exchange to effect a transaction in a security, or to report any such transaction, unless such exchange is registered under Section 6 of the Exchange Act).

[149] *See* Section 3(a)(1) of the Exchange Act, 15 U.S.C. 78c (defining ''exchange'') and Rule 3b–16 under the Exchange Act, 17 CFR 240–3b–16 (further elaborating on the definition of ''exchange'' contained in the Exchange Act).

[150] 15 U.S.C. 78q–1(b)(1).

[151] *Id.*

[152] *See* Exchange Act Release Nos. 43775 (Dec. 28, 2000), 66 FR 819 (order exempting Euroclear Bank from clearing agency registration) and 39643 (Feb. 18, 1998), 63 FR 8232 (order exempting Euroclear Bank's predecessor, Morgan Guaranty Trust Company, as operator of the Euroclear system, from clearing agency registration) and Exchange Act Release No. 38328 (Feb. 24, 1997), 62 FR 9225 (order exempting Clearstream Bank, formerly Cedel Bank, from clearing agency registration).

[153] With exchange traded options, the clearing house is the issuer of the option security. *See*

unless the foreign options were registered under the Securities Act, foreign option transactions involving U.S. persons would be required to come within an exemption from registration. To the extent that the activities undertaken by foreign options exchange in the United States can be deemed to constitute offers of foreign options under the Securities Act, such activities must also be undertaken in a fashion that is consistent with the requirements of the applicable exemption.[154]

5. Request for Comment

The Commission seeks comment on the proposed exemption in paragraph (a)(5) for transactions effected by a foreign broker-dealer on a foreign options exchange of which it is a member. Should the Commission require a foreign broker-dealer or a representative of a foreign options exchange to determine that the persons with whom the representative communicates or otherwise provides information under proposed paragraphs (a)(5)(i)(A)–(C) are, in fact, qualified investors? Should the exemption be limited to unsolicited transactions? As a practical matter, because of the broad interpretation of solicitation, would foreign broker-dealers effecting transactions with qualified investors that have been approached by the representatives of a foreign options exchange effect these transactions in reliance on proposed paragraph (a)(3) of Rule 15(a)(6)? If not, should the proposed exemption permit foreign broker-dealers to engage in additional limited solicitation activities, such as the types of contacts that would be expected in an ongoing customer relationship? In general, should foreign representatives of foreign options exchanges or foreign options exchanges be permitted to engage in any other activities under the proposed rule? If so, what? Given the purpose of the exemption to allow familiarization activities for foreign options exchanges, are there other types of markets for which it would be appropriate to permit familiarization activities? If so, which markets and what should the permissible range of activities be? Should they be broader or narrower than the permissible range of activities for foreign options exchanges? If so, why? Commenters are requested to explain their views.

Securities Act Release No. 8171 (Dec. 23, 2002), 68 FR 188, 188 (Jan. 2, 2003).

[154] For example, to the extent that reliance is based on Securities Act Section 4(2), the activities of the foreign options exchange must not constitute a public offering of the securities.

G. Scope of the Proposed Exemption

When we adopted Rule 15a–6 in 1989, the Commission had authority, under Section 15(a)(2) of the Exchange Act, only to conditionally or unconditionally exempt from the broker-dealer registration requirements of Section 15(a)(1) any broker-dealer or class of broker-dealers, by rule or order, as it deems consistent with the public interest and the protection of investors.[155] However, many of the statutory and regulatory provisions under the Exchange Act actually are applicable by their terms to broker-dealers regardless of their registration status.[156] To provide foreign broker-dealers relying on the exemptions in Rule 15a–6 with relief from these provisions, the Commission stated in the 1989 Adopting Release, ''Nevertheless, the staff would not recommend that the Commission take enforcement action against foreign broker-dealers for want of compliance with those provisions, with the exception of sections 15(b)(4) and 15(b)(6), if the foreign broker-dealers were exempt from broker-dealer registration under the Rule.'' [157]

Since 1996, the Commission has had general exemptive authority under Section 36 of the Exchange Act to conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from any provision or provisions of the Exchange Act or any rule or regulation thereunder, by rule, regulation or order, to the extent that such exemption is necessary or appropriate in the public interest and is consistent with the protection of investors.[158]

The Commission proposes to amend Rule 15a–6 to exempt foreign broker-dealers from not only the registration requirements of Section 15(a)(1) or 15B(a)(1) of the Exchange Act, but also from the reporting and other requirements of the Exchange Act (other than Sections 15(b)(4) and 15(b)(6)), and the rules and regulations thereunder, that apply specifically to a broker-dealer solely by virtue of its status as a broker or dealer rather than because of its registration with the Commission.

Under the proposed rule, as under the current rule, however, foreign broker-dealers would not be exempt from provisions of the Exchange Act, and the rules and regulations thereunder, that are not specific to broker-dealers, such as Section 10(b) of the Exchange Act, or Rule 10b–5 thereunder.[159] Such rules apply to ''persons'' regardless of their registration status, and thus apply equally to registered broker-dealers, unregistered broker-dealers and non-broker-dealers. We also do not propose to exempt foreign broker-dealers from Exchange Act Sections 15(b)(4) and 15(b)(6), which give the Commission the authority to sanction broker-dealers and persons associated with broker-dealers, because these sections provide the Commission with flexibility to impose a bar against or place other limitations on associated persons or place limitations on broker-dealers in the circumstances specified in these sections.

As discussed more fully below with respect to each of the exemptions in the proposed rule, the Commission preliminarily believes that exempting foreign broker-dealers from the registration requirements of Sections 15(a)(1) and 15B(a)(1) of the Exchange Act and the reporting and other requirements of the Exchange Act (other than Sections 15(b)(4) and 15(b)(6)), and the rules and regulations thereunder, that apply specifically to a broker-dealer that is not registered with the Commission solely by virtue of its status as a broker or dealer would be necessary or appropriate in the public interest, and would be consistent with the protection of investors.

1. Proposed Rule 15a–6(a)(2)

As discussed above, proposed rule 15a–6(a)(2) would permit a foreign broker-dealer to provide research reports to qualified investors, but not otherwise induce or attempt to induce the purchase or sale of any security by qualified investors.[160] Based on conversations with industry participants, we understand that foreign broker-dealers rarely rely on current Rule 15a–6(a)(2). This is in part because of the limitations on solicitation, as well as the requirement that if a foreign broker-dealer has a relationship with a U.S. registered broker-dealer that satisfies the requirement of paragraph (a)(3) of the current rule, any

[155] *See* 15 U.S.C. 78o(a)(2); *see also* Section 15B(a)(4) of the Exchange Act, 15 U.S.C. 78o–4(a)(4) (giving the Commission similar authority with respect to municipal securities dealers).

[156] *See* 1989 Adopting Release, 54 FR at 30015 n.22 (''*E.g.*, sections 15(b)(4) and 15(b)(6) of the Exchange Act, 15 U.S.C. 78o(b)(4) and 78o(b)(6); Rules 15c3–1, 15c3–3, 17a–3, 17a–4, and 17a–5, 17 CFR 240.15c3–1, 15c3–3, 17a–3, 17a–4, and 17a–5'').

[157] *See* 1989 Adopting Release, 54 FR at 30015 n.22.

[158] *See* 15 U.S.C. 78mm; *see also* Capital Markets Efficiency Act of 1996, Sec. 105(b), Pub. Law 104–290, 110 Stat. 3416 (1996) (adding Section 36 to the Exchange Act).

[159] The proposed rule also would not affect any obligations a foreign broker-dealer may have under any other law, including the Securities Act.

[160] *See* Part III.C., *supra*.

transactions with the foreign broker-dealer in securities discussed in the research reports must be effected pursuant to the provisions of paragraph (a)(3).[161]

Given the *de minimis* volume of transactions that likely would be conducted,[162] and the level of financial sophistication of the investors that could receive the research reports under this proposed exemption, as well as the fact that the foreign broker-dealer would not otherwise be permitted to induce or attempt to induce the purchase or sale of any security by those investors under the proposed exemption, the Commission preliminarily believes that it would be necessary or appropriate in the public interest, and would be consistent with the protection of investors, to exempt foreign broker-dealers relying on paragraph (a)(2) of the proposed rule from the registration requirements of Sections 15(a)(1) and 15B(a)(1) of the Exchange Act and the reporting and other requirements of the Exchange Act (other than Sections 15(b)(4) and 15(b)(6)), and the rules and regulations thereunder, that apply specifically to a broker-dealer that is not registered with the Commission solely by virtue of its status as a broker or dealer.

The Commission solicits comment on whether it would be necessary or appropriate in the public interest, and consistent with the protection of investors, to exempt foreign broker-dealers relying on paragraph (a)(2) of the proposed rule from such rules and requirements. If not, which provisions or rules should apply and why?

2. Proposed Rule 15a–6(a)(3)

a. Exemption (A)(*1*)

As discussed above, foreign broker-dealers relying on proposed Exemption (A)(*1*) under Rule 15a–6(a)(3) would be required to conduct a foreign business.[163] The proposed rule would define ‘‘foreign business’’ to mean the business of a foreign broker-dealer with qualified investors and foreign resident clients [164] where at least 85% of the aggregate value of the securities purchased or sold in transactions conducted pursuant to both paragraphs (a)(3) and (a)(4)(vi) of the proposed rule by the foreign broker-dealer, calculated on a rolling two-year basis, is derived from transactions in foreign securities, as defined above.[165] As explained above, the Commission believes that making Exemption (A)(*1*) available only to a foreign broker-dealer conducting a foreign business would provide U.S. investors increased access to foreign securities and markets without creating opportunities for regulatory arbitrage vis-à-vis U.S. securities markets because the foreign broker-dealer's business in U.S. securities would be limited.

Given the requirement that foreign broker-dealers conduct a foreign business and the sophistication of qualified investors, as well as the other investor protections in the proposed rule, the Commission preliminarily believes that it would be necessary or appropriate in the public interest, and would be consistent with the protection of investors to exempt foreign broker-dealers relying on Exemption (A)(*1*) of the proposed rule from the registration requirements of Sections 15(a)(1) and 15B(a)(1) of the Exchange Act and the reporting and other requirements of the Exchange Act (other than Sections 15(b)(4) and 15(b)(6)), and the rules and regulations thereunder, that apply specifically to a broker-dealer that is not registered with the Commission solely by virtue of its status as a broker or dealer.

The Commission solicits comment on whether it would be necessary or appropriate in the public interest, and consistent with the protection of investors, to exempt foreign broker-dealers relying on Exemption (A)(*1*) from such rules and requirements. If not, which rules should apply and why? Alternatively, and as under current Rule 15a–6(a)(3), should the intermediating U.S. registered broker-dealer be required to comply with certain rules in lieu of the foreign broker-dealer? If so, which rules and why? Should the requirements differ based on whether the securities are U.S. securities or foreign securities and where the transactions are executed? Would exempting foreign broker-dealers from such rules and regulations place U.S. registered broker-dealers at a competitive disadvantage?

b. Exemption (A)(*2*)

Under proposed Exemption (A)(*2*), qualified investors that have an account with a U.S. registered broker-dealer would have access to foreign broker-dealers regardless of the types of securities that are involved. Foreign broker-dealers relying on proposed Exemption (A)(*2*) would be permitted to effect transactions in securities, provided, among other things, that a U.S. registered broker-dealer acts as custodian for any resulting transactions.[166] As a result, a U.S. registered broker-dealer would hold the funds and securities of the qualified investor and be subject to the Commission's rules relating to the safeguarding of customer assets, such as Exchange Act Rule 15c3–3. As with proposed Exemption (A)(*1*), proposed Exemption (A)(*2*) would be limited to transactions with qualified investors, which we believe are sophisticated investors that can be expected to understand the risk of dealing with foreign broker-dealers that are not regulated by the Commission.

Given the requirement that a U.S. registered broker-dealer maintain custody of qualified investors' funds and securities from any resulting transactions and the sophistication of qualified investors, as well as the other investor protections in the proposed rule, the Commission preliminarily believes that it would be necessary or appropriate in the public interest, and would be consistent with the protection of investors, to exempt foreign broker-dealers relying on Exemption (A)(*2*) of the proposed rule from the registration requirements of Sections 15(a)(1) and 15B(a)(1) of the Exchange Act and the reporting and other requirements of the Exchange Act (other than Sections 15(b)(4) and 15(b)(6)), and the rules and regulations thereunder, that apply specifically to a broker-dealer that is not registered with the Commission solely by virtue of its status as a broker or dealer.

The Commission solicits comment on whether it would be necessary or appropriate in the public interest, and consistent with the protection of investors, to exempt foreign broker-dealers relying on Exemption (A)(*2*) from such rules and requirements. If not, which rules should apply and why? Alternatively, as under current Rule 15a–6(a)(3), should the intermediating U.S. registered broker-dealer be required to comply with certain rules in lieu of the foreign broker-dealer? If so, which rules and why? Should the requirements differ based on whether the securities are U.S. securities or foreign securities and where the transactions are executed? Would exempting foreign broker-dealers from such rules and regulations place U.S. registered broker-dealers at a competitive disadvantage?

3. Proposed Rule 15a–6(a)(4)

As explained above, paragraph (a)(4) of proposed Rule 15a–6 would provide an additional exemption for foreign broker-dealers that effect transactions

[161] *See* 17 CFR 240.15a–6(a)(2)(iii).

[162] This estimate is based on information the staff obtained in discussions with industry representatives.

[163] *See* Part III.D.1.a., *supra.*

[164] *See* Part III.E., *supra.*

[165] *See* proposed Rule 15a–6(b)(3).

[166] *See* Part III.D.1.b., *supra.*

for certain classes of investors, namely, U.S. persons that act in a fiduciary capacity for an account of a foreign resident client.[167]

Because of the nature and/or location of these persons, the Commission preliminarily believes that it would be necessary or appropriate in the public interest, and would be consistent with the protection of investors, to exempt foreign broker-dealers relying on paragraph (a)(4)(vi) of the proposed rule from the registration requirements of Sections 15(a)(1) and 15B(a)(1) of the Exchange Act and the reporting and other requirements of the Exchange Act (other than Sections 15(b)(4) and 15(b)(6)), and the rules and regulations thereunder, that apply specifically to a broker-dealer that is not registered with the Commission solely by virtue of its status as a broker or dealer.

The Commission solicits comment on whether it would be necessary or appropriate in the public interest, and be consistent with the protection of investors, to exempt foreign broker-dealers relying on paragraph (a)(4)(vi) of the proposed rule from such rules and requirements. If not, which rules should apply and why?

4. Proposed Rule 15a–6(a)(5)

As explained above, paragraph (a)(5) of proposed Rule 15a–6 would allow a foreign broker-dealer that is a member of a foreign options exchange to effect transactions in options on foreign securities listed on that exchange for a qualified investor that has not otherwise been solicited by the foreign broker-dealer.[168] Under this exemption, a foreign broker-dealer, a foreign options exchange and representatives of the foreign options exchange could conduct certain activities or communicate with a qualified investor in a manner that might otherwise be considered a form of solicitation, as described above.[169] Transactions effected by or through the foreign broker-dealer with or for qualified investors that result from these activities or communications would not require registration or, in some situations, compliance with proposed Rule 15a–6(a)(3). However, while these activities would not necessarily constitute a form of solicitation, the Commission anticipates that given the broad interpretation of solicitation, it would be difficult, if not impractical, to conduct repeated transactions with the same qualified investor without a foreign broker-dealer engaging in some form of communication that would constitute solicitation. Therefore, the Commission anticipates that most transactions with qualified investors resulting from these activities or communications would need to be completed pursuant to proposed Rules 15a–6(a)(3).

Hence, for the reasons given above in the discussion of paragraphs (a)(2) and (a)(3) of the proposed rule, the Commission preliminarily believes that it would be necessary or appropriate in the public interest, and would be consistent with the protection of investors to exempt foreign broker-dealers relying on paragraph (a)(5) of the proposed rule from the registration requirements of Sections 15(a)(1) and 15B(a)(1) of the Exchange Act and the reporting and other requirements of the Exchange Act (other than Sections 15(b)(4) and 15(b)(6)), and the rules and regulations thereunder, that apply specifically to a broker-dealer that is not registered with the Commission solely by virtue of its status as a broker or dealer.

The Commission solicits comment on whether it would be necessary or appropriate in the public interest, and be consistent with the protection of investors, to exempt foreign broker-dealers relying on paragraph (a)(5) of the proposed rule from such rules and requirements. If not, which rules should apply and why?

IV. Preliminary Findings

Section 15(a)(2) of the Exchange Act provides that the Commission, by rule or order, as it deems consistent with the public interest and the protection of investors, may conditionally or unconditionally exempt from Section 15(a)(1) any broker or dealer or class of brokers or dealers. Section 36 of the Exchange Act provides general exemptive authority to the Commission to exempt any person or class of persons or transactions from any provision of the Exchange Act, to the extent that such exemption is necessary or appropriate in the public interest and is consistent with the protection of investors. As described in Part III.G., above, the Commission preliminarily believes that the proposed exemptions would be necessary or appropriate in the public interest and would be consistent with the protection of investors.

V. General Request for Comment

In addition to the specific requests for comment above, the Commission seeks comment generally on all aspects of the proposed amendments to Rule 15a–6 under the Exchange Act. The Commission anticipates that all prior staff no-action relief under Rule 15a–6 would be superseded if the Commission were to adopt this proposed rule and interpretive guidance. Are there additional issues stemming from the 1989 Adopting Release or related staff guidance that are not addressed in the proposal and that should be addressed by this rule or interpretive guidance? Commenters are invited to provide empirical data to support their views. Comments are of the greatest assistance to our rulemaking initiatives if accompanied by supporting data and analysis of the issues addressed, and if accompanied by alternative suggestions to our proposals when appropriate. Commenters are also welcome to offer their views on any other issues raised by the proposed amendments to Rule 15a–6.

VI. Administrative Law Matters

A. Paperwork Reduction Act Analysis

Certain provisions of current Rule 15a–6 contain ''collection of information'' requirements within the meaning of the Paperwork Reduction Act of 1995.[170] The Commission has previously submitted these information collections to the Office of Management and Budget (''OMB'') for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The revised collections of information in the proposed amendments would impose certain burdens on U.S. registered broker-dealers, foreign broker-dealers and U.S. persons acting as fiduciaries as described in proposed Rule 15a–6(a)(4)(vi). The Commission has submitted the revised collections of information, entitled ''Rule 15a–6 under the Securities Exchange Act of 1934—Exemption of Certain Foreign Brokers or Dealers'' (OMB control No. 3235–0371), to the OMB for review. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number.[171]

1. Related Collections of Information Under Proposed Paragraphs (a)(3)(i)(B) and (C) and (a)(3)(iii)(C) and (D)

Current paragraph (a)(3)(ii)(B) of Rule 15a–6 requires a U.S. registered broker-dealer to determine that the foreign associated persons of a foreign broker-dealer effecting transactions with U.S. institutional investors or major U.S. institutional investors are not subject to a statutory disqualification as defined in Section 3(a)(39) of the Exchange Act, or certain substantially equivalent foreign

[167] *See* Part III.E., *supra.*

[168] *See* Part III.F., *supra.*

[169] *See* proposed Rules 15a–6(a)(5)(i)–(iii).

[170] 44 U.S.C. 3501 *et seq.*

[171] *See* 44 U.S.C. 3512.

disciplinary actions. As described above, because the foreign equivalents of statutory disqualification are now included in Section 3(a)(39), the proposed rule would no longer separately describe them.[172] In addition, the proposed rule would place the burden on the foreign broker-dealer to determine that its foreign associated persons effecting transactions with a qualified investor are not subject to a statutory disqualification as defined in Section 3(a)(39) of the Exchange Act.[173]

Current paragraph (a)(3)(iii)(C) of Rule 15a–6 requires a U.S. registered broker-dealer to obtain from the foreign broker-dealer, with respect to each foreign associated person, the types of information specified in Rule 17a–3(a)(12) under the Exchange Act,[174] provided that the information required by paragraph (a)(12)(i)(D) of that rule includes sanctions imposed by foreign securities authorities, exchanges, or associations, including statutory disqualification.[175] Proposed paragraph (a)(3)(i)(C) of Rule 15a–6 would require that the foreign broker-dealer have such information regarding its foreign associated persons in its files.

Proposed paragraphs (a)(3)(iii)(C) and (D) of Rule 15a–6 would require that a registered broker-dealer obtain and record a representation from the foreign broker-dealer that the foreign broker-dealer has determined that its foreign associated persons effecting transactions with a qualified investor are not subject to a statutory disqualification as defined in Section 3(a)(39) of the Exchange Act and has the information required by proposed paragraph (a)(3)(i)(C) of Rule 15a–6 in its files.

a. Collection of Information

Proposed paragraphs (a)(3)(i)(B) and (C) and (a)(3)(iii)(C) and (D) of Rule 15a–6 all would require ''collections of information,'' as that term is defined in 44 U.S.C. 3502(3). Proposed paragraph (a)(3)(i)(B) would require a foreign broker-dealer to make a determination that its foreign associated persons effecting transactions with a qualified investor are not subject to a statutory disqualification as defined in Section 3(a)(39) of the Exchange Act.[176] Proposed paragraph (a)(3)(i)(C) would require that the foreign broker-dealer have in its files information specified in Rule 17a–3(a)(12) under the Exchange Act, including information related to sanctions imposed by foreign securities authorities, foreign exchanges, or foreign associations.[177] Thus, each requires a collection of information by the foreign broker-dealer.

Proposed paragraph (a)(3)(iii)(C) would require that a U.S. registered broker-dealer obtain a representation from the foreign broker-dealer that the foreign broker-dealer has made the determinations that would be required by proposed paragraph (a)(3)(i)(B) and has in its files the information that would be required by proposed paragraph (a)(3)(i)(C). Proposed paragraph (a)(3)(iii)(C) therefore would require a collection of information by both the foreign broker-dealer and the U.S. registered broker-dealer in that the foreign broker-dealer must provide the representation and the U.S. registered broker-dealer must obtain that representation.

Proposed paragraph (a)(3)(iii)(D) would require a U.S. registered broker-dealer to maintain a record of the representations it obtains pursuant to proposed paragraph (a)(3)(iii)(C). This proposed paragraph would require a collection of information by the U.S. registered broker-dealer.

b. Proposed Use of Information

The collections of information under proposed paragraphs (a)(3)(i)(B) and (C) and proposed paragraphs (a)(3)(iii)(C) and (D) are intended to protect U.S. investors from contacts with foreign associated persons with a disciplinary history.

c. Respondents

As discussed above, proposed paragraphs (a)(3)(i)(B) and (C) and proposed paragraphs (a)(3)(iii)(C) and (D) of Rule 15a–6 would require collections of information by both foreign broker-dealers and U.S. registered broker-dealers. All foreign broker-dealers that take advantage of the exemption from registration under the proposed rule would be required to comply with proposed paragraphs (a)(3)(i)(B) and (C) and proposed paragraph (a)(3)(iii)(C). The Commission estimates that approximately 700 foreign broker-dealers would take advantage of the exemption from registration under the proposed rule and therefore be subject to the collection of information requirements in proposed paragraphs (a)(3)(i)(B) and (C) and proposed paragraph (a)(3)(iii)(C).[178]

Similarly, all U.S. registered broker-dealers engaged by foreign broker-dealers to assume the responsibilities of a U.S. registered broker-dealer under the proposed rule, under either exemption, would be required to comply with proposed paragraphs (a)(3)(iii)(C) and (D). The Commission estimates that approximately 40 U.S. registered broker-dealers would be engaged by foreign broker-dealers to assume the responsibilities under Exemption (A)(*1*) and approximately 18 U.S. registered broker-dealers would be engaged by foreign broker-dealers to assume the responsibilities under Exemption (A)(*2*) under the proposed rule, for a total of approximately 58 U.S. registered broker-dealers assuming the responsibilities under paragraph (a)(3)(iii) and therefore be subject to the collection of information requirements in proposed paragraphs (a)(3)(iii)(C) and (D).

d. Reporting and Recordkeeping Burden

The Commission estimates for the purposes of proposed paragraph (a)(3)(i)(B) that each of the approximately 700 foreign broker-dealer respondents would employ approximately 5 foreign associated persons that would effect transactions with qualified investors and would spend approximately 10 hours per year determining that these foreign associated persons are not subject to a statutory disqualification as defined in Section 3(a)(39) of the Exchange Act.[179] The Commission also estimates for the purposes of proposed paragraph (a)(3)(i)(C) that each of the

[172] *See* Part III.D.3., *supra*; *see also* proposed Rule 15a–6(a)(3)(i)(B).

[173] *See* proposed Rule 15a–6(a)(3)(i)(B).

[174] *See* Part III.D.3., *supra*.

[175] *See* 17 CFR 240.15a–6(a)(3)(iii)(C).

[176] *See* proposed Rule 15a–6(a)(i)(B).

[177] *See* proposed Rule 15a–6(a)(i)(C).

[178] Based on information the staff obtained in discussions with industry representatives, the Commission estimates that approximately 40 U.S. registered broker-dealers would serve as U.S. registered broker-dealers under Exemption (A)(*1*) under the proposed rule. The Commission estimates that each of these 40 U.S. registered broker-dealers would do so for an average of 10 foreign broker-dealers, so that an estimated total of 400 foreign broker-dealers would utilize Exemption (A)(*1*) under the proposed rule. The Commission also estimates based on information the staff obtained in discussions with industry that approximately 18 U.S. registered broker-dealers would be engaged under Exemption (A)(*2*) by foreign broker-dealers relying on the exemption provided by paragraph (a)(3)(iii)(A)(*2*) of the proposed rule. The Commission believes that Exemption (A)(*2*) under the proposed rule would be utilized by approximately 300 foreign broker-dealers (an average of 16.67 per each of the 18 U.S. registered broker-dealers acting under Exemption (A)(*2*)—assuming an even distribution of foreign broker-dealers per U.S. registered broker-dealer operating under the exemption, some U.S. registered broker-dealers would do so for 16 foreign broker-dealers and some would do so for 17 foreign broker-dealers). Therefore, the Commission estimates that a total of 700 foreign broker-dealers would take advantage of one or both exemptions from registration under the proposed rule.

[179] As noted above, the bases for these estimates come from information the staff obtained in discussions with industry representatives. Unless otherwise indicated, each of the Commission's estimates used for the purposes of calculating the number of respondents or the burden imposed upon those respondents is based on such discussions.

approximately 700 foreign broker-dealer respondents would spend approximately 10 hours per year complying with the terms of that proposed paragraph. Thus, the Commission estimates for the purposes of proposed paragraph (a)(3)(iii)(C) that each of the approximately 700 foreign broker-dealer respondents would spend approximately 5 hours per year providing representations to U.S. registered broker-dealers that they have complied with proposed paragraphs (a)(3)(i)(B) and (C). Therefore, the annual burden imposed by proposed paragraphs (a)(3)(i)(B) and (C) and proposed paragraph (a)(3)(iii)(C) on each of the 700 foreign broker-dealers would be approximately 25 hours for an aggregate annual burden on all foreign broker-dealers of 17,650 hours (700 foreign broker-dealers × 25 hours per foreign broker-dealer).

The Commission estimates for the purposes of proposed paragraphs (a)(3)(iii)(C) and (D) that each U.S. registered broker-dealer acting under Exemption (A)(*1*) would spend approximately 5 hours each year obtaining and recording representations required by proposed paragraphs (a)(3)(iii)(C) and (D). Similarly, the Commission estimates that each U.S. registered broker-dealer acting under Exemption (A)(*2*) would spend approximately 8 hours each year obtaining and recording representations required by proposed paragraphs (a)(3)(iii)(C) and (D). Thus, the aggregate annual burden imposed by proposed paragraphs (a)(3)(i)(C) and (D) on all U.S. registered broker-dealers would be approximately 344 hours (40 U.S. registered broker-dealers acting under Exemption (A)(*1*) multiplied by 5 hours per broker-dealer plus 18 U.S. registered broker-dealers acting under Exemption (A)(*2*) multiplied by 8 hours per broker-dealer).

e. Collection of Information Is Mandatory

These collections of information would be mandatory for foreign broker-dealers that choose to rely on the exemptions in paragraph (a)(3) of the proposed rule and U.S. registered broker-dealers that intermediate transactions for foreign broker-dealers that choose to rely on the exemptions in paragraph (a)(3) of the proposed rule.

f. Confidentiality

Proposed paragraph (a)(3)(i)(C) would require foreign broker-dealers to have in their files the type of information specified in Rule 17a–3(a)(12) under the Exchange Act, provided that the information required by paragraph (a)(12)(i)(D) of Rule 17a–3 shall include information relating to sanctions imposed by foreign securities authorities, foreign exchanges or foreign associations, including without limitation those described in Section 3(a)(39) of the Exchange Act. Proposed paragraph (a)(3)(iii)(D) would require U.S. registered broker-dealers to maintain a written record of the representations obtained from foreign broker-dealers, as required by proposed paragraph (a)(3)(iii)(C).

All information related to transactions with qualified investors, whether kept by U.S. registered broker-dealers or foreign broker-dealers, would be subject to review and inspection by the Commission and its representatives as required in connection with examinations, investigations and enforcement proceedings. Such information is not required to be disclosed to the public and will be kept confidential by the Commission.

g. Record Retention Period

Proposed paragraphs (a)(3)(i)(B) and (C) and proposed paragraphs (a)(3)(iii)(C) and (D) would not include record retention periods. However, the U.S. registered broker-dealers would have to retain the representations for the period specified under 17 CFR 240.17a–4(b)(7), which requires broker-dealers to preserve all written agreements they enter into relating to their business for a period of not less than three years, the first two years in an easily accessible place.

2. Collection of Information Under Proposed Paragraph (a)(3)(i)(D)

a. Collection of Information

Proposed paragraph (a)(3)(i)(D) would require ''collections of information,'' as that term is defined in 44 U.S.C. 3502(3), by foreign broker-dealers. Proposed paragraph (a)(3)(i)(D) would require that a foreign broker-dealer relying on either Exemption (A)(*1*) or Exemption (A)(*2*) disclose to qualified investors that the foreign broker dealer is regulated by a foreign securities authority and not by the Commission. Foreign broker-dealers relying on Exemption (A)(*1*) would also have to disclose to qualified investors whether U.S. segregation requirements, U.S. bankruptcy protections and protections under the SIPA would apply to any funds and securities held by the foreign broker-dealer.

b. Proposed Use of Information

The collections of information required by proposed paragraph (a)(3)(i)(D) are designed to put U.S. investors on notice that foreign broker-dealers operating pursuant to the exemption in Rule 15a–6(a)(3)(iii)(A)(*1*) are not subject to the same regulatory requirements as U.S. registered broker-dealers. This notice is important because the proposed rule would eliminate the current chaperoning requirements, as described below, and allow a foreign broker-dealer to effect transactions on behalf of qualified investors and custody qualified investor funds and securities relating to any resulting transactions with more limited participation in the transaction by a U.S. registered broker-dealer.[180]

c. Respondents

As discussed above, the Commission estimates that approximately 400 foreign broker-dealers would rely on Exemption (A)(*1*) of the proposed rule. All 400 foreign broker-dealers would be required to comply with proposed paragraph (a)(3)(i)(D). The Commission also estimates that approximately 300 foreign broker-dealers would rely on Exemption (A)(2) of the proposed rule. These 300 foreign broker-dealers would only be required to comply with proposed paragraph (a)(3)(i)(D)(*1*).

d. Reporting and Recordkeeping Burden

Each of the 700 foreign broker-dealers that would rely on either Exemption (A)(*1*) or Exemption (A)(*2*) of the proposed rule would have to make certain disclosures required by proposed paragraph (a)(3)(i)(D) to each qualified investor from which the foreign broker-dealer induces or attempts to induce the purchase or sale of any security. The Commission believes that such disclosures would be conveyed in the course of other communications between the foreign broker-dealer and the qualified investor, such as the foreign broker-dealer's standard account-opening documentation. Thus, we expect that the only collection of information burden that proposed paragraph (a)(3)(i)(D) would impose on a foreign broker-dealer would be the hour burden incurred in developing and updating as necessary the standard documentation it will provide to qualified investors. In addition, the Commission does not believe that there would be a significant difference in the burden placed foreign broker-dealers relying on either Exemption (A)(*1*) or Exemption (A)(*2*) of the proposed rule by proposed paragraph (a)(3)(i)(D). The Commission

[180] Similarly, because of the limited participation of the U.S. registered broker-dealer and the lack of chaperoning requirements, the proposed rule would require that the foreign broker-dealer be regulated for conducting securities activities in a foreign country by a foreign securities authority.

estimates that each of the 700 foreign broker-dealers that would rely on either Exemption (A)(*1*) or Exemption (A)(*2*) of the proposed rule would spend approximately 2 hours per year in drafting, reviewing or updating as necessary their standard documentation for compliance with proposed paragraph (a)(3)(i)(D). Therefore, the aggregate annual collection of information burden imposed by proposed paragraph (a)(3)(i)(D) on foreign broker-dealers would be approximately 1,400 hours (700 foreign broker-dealers multiplied by 2 hours per foreign broker-dealer).

e. Collection of Information Is Mandatory

This collection of information would be mandatory for foreign broker-dealers that rely on either Exemption (A)(*1*) or Exemption (A)(*2*) of the proposed rule.

f. Confidentiality

The disclosures required by proposed paragraph (a)(3)(i)(D) would be conveyed to a qualified investor in the course of communications between the foreign broker-dealer and the qualified investor, such as the foreign broker-dealer's standard account-opening documentation, and therefore would not be confidential.

g. Record Retention Period

Proposed paragraph (a)(3)(i)(D) would not include a record retention period.

3. Related Collections of Information Under Proposed Paragraphs (a)(3)(iii)(B) and (D)

a. Collection of Information

Proposed paragraphs (a)(3)(iii)(B) and (D) would require ''collections of information,'' as that term is defined in 44 U.S.C. 3502(3), by U.S. registered broker-dealers. Proposed paragraph (a)(3)(iii)(B) would require that a U.S. registered broker-dealer obtain from a foreign broker-dealer and each of the foreign broker-dealer's foreign associated persons written consents to service of process for any civil action brought by or proceeding before the Commission or a self-regulatory organization (as defined in Section 3(a)(26) of the Exchange Act).[181] Proposed paragraph (a)(3)(iii)(D) would require that the U.S. registered broker-dealer maintain a written record of the consents to service of process obtained pursuant to proposed paragraph (a)(3)(iii)(B).

b. Proposed Use of Information

The collections of information under proposed paragraphs (a)(3)(iii)(B) and (D) are designed to assist the Commission in its regulatory function by ensuring that foreign broker-dealers and their foreign associated persons effecting transactions with qualified investors have consented to service of process.

c. Respondents

All U.S. registered broker-dealers engaged by foreign broker-dealers to assume the responsibilities of a U.S. registered broker-dealer under the proposed exemption would be subject to the collections of information. As discussed above, the Commission estimates that approximately 40 U.S. registered broker-dealers would act under Exemption (A)(*1*) for foreign broker-dealers relying on the exemption provided by paragraph (a)(3)(iii)(A)(*1*) of the proposed rule and that approximately 18 U.S. registered broker-dealers would act under Exemption (A)(*2*). Therefore, the Commission estimates that a total of approximately 58 U.S. registered broker-dealers would have to comply with the collection of information requirements in proposed paragraphs (a)(3)(iii)(B) and (D).[182]

d. Reporting and Recordkeeping Burden

As discussed above, the Commission estimates that each of the 40 U.S. registered broker-dealers that would serve under Exemption (A)(*1*) for affiliated foreign broker-dealers under the proposed rule would do so for an average of 10 foreign broker-dealers. The Commission also estimates that each such foreign broker-dealer would have an average of 5 foreign associated persons engaged in business under the proposed rule. Therefore, proposed paragraphs (a)(3)(iii)(B) and (D) would require each U.S. registered broker-dealer acting under Exemption (A)(*1*) to obtain and record a total of 50 consents to service of process from foreign associated persons and 10 consents to service of process from foreign broker-dealers.

As discussed above, the Commission estimates that each of the 18 U.S. registered broker-dealers that would serve under Exemption (A)(*2*) for qualified investors would do so for approximately 16.67 foreign broker-dealers. Also as discussed above, the Commission estimates that each such foreign broker-dealer would have an average of 5 foreign associated persons engaged in business under the proposed rule. Therefore, proposed paragraphs (a)(3)(iii)(B) and (D) would require a U.S. registered broker-dealer acting under Exemption (A)(*2*) to obtain a total of 83.35 consents to service of process from foreign associated persons and 16.67 consents to service of process from foreign broker-dealers.[183]

The Commission further estimates that each affected U.S. registered broker-dealer, acting under either exemption, would spend an average of 0.5 hours in obtaining and recording one consent under proposed paragraphs (a)(3)(iii)(B) and (D). Each U.S. registered broker-dealer acting under Exemption (A)(*1*) would therefore spend an average of 35 hours per year in its efforts at compliance with proposed paragraphs (a)(3)(iii)(B) and (D) (0.5 hours per consent per representation multiplied by the sum of 50 consents from foreign associated persons plus 10 consents to service of process from foreign broker-dealers plus 10 representations). Similarly, each U.S. registered broker-dealer acting under Exemption (A)(*2*) would spend an average of 50.01 hours per year in its efforts at compliance with proposed paragraphs (a)(3)(iii)(B) and (D) (0.5 hours per consent per representation multiplied by the sum of 83.35 consents from foreign associated persons plus 16.67 consents to service of process from foreign broker-dealers). Therefore, the Commission estimates an annual aggregate reporting and recordkeeping burden of 2,300.18 hours for compliance with proposed paragraphs (a)(3)(iii)(B) and (D) (35 hours per 40 registered broker-dealers acting under Exemption (A)(*1*) for a total of 1,400 hours, plus 50.01 hours per 18 registered broker-dealers acting under Exemption (A)(*2*) for a total of 900.18 hours).

e. Collection of Information Is Mandatory

This collection of information would be mandatory for U.S. registered broker-dealers that intermediate transactions for foreign broker-dealers that choose to

[181] The consent would indicate that process may be served on the foreign broker-dealer or foreign associated person by service on the U.S. registered broker-dealer in the manner set forth on the U.S. registered broker-dealer's current Form BD. *See* proposed Rule 15a–6(a)(3)(iii)(B).

[182] The Commission understands that U.S. registered broker-dealers acting under Exemption (A)(*2*) are likely to also act under Exemption (A)(*1*) under the proposed rule. The Commission requests comment regarding how frequently this would occur.

[183] Assuming a relatively even distribution of the estimated 300 foreign broker-dealers across the 18 U.S. registered broker-dealers acting under Exemption (A)(*2*), proposed paragraphs (a)(3)(iii)(B) and (D) would require some U.S. registered broker-dealers acting under Exemption (A)(*2*) to obtain and record 83 consents to service of process from foreign associated persons and some to obtain and record 84 consents to service of process from foreign associated persons.

rely on the exemption in paragraph (a)(3) of the proposed rule.

f. Confidentiality

The proposed rule would require that U.S. registered broker-dealers maintain a written record of the information and consents and make such records available to the Commission upon request. All information related to transactions with qualified investors, whether kept by U.S. registered broker-dealers or foreign broker-dealers, would be subject to review and inspection by the Commission and its representatives as required in connection with examinations, investigations and enforcement proceedings. Such information is not required to be disclosed to the public and will be kept confidential by the Commission.

g. Record Retention Period

Proposed paragraphs (a)(3)(iii)(B) and (D) would not include separate record retention periods. However, the U.S. registered broker-dealers would have to retain the consents for the period specified under 17 CFR 240.17a–4(b)(7), which requires broker-dealers to preserve all written agreements they enter into relating to their business for a period of not less than three years, the first two years in an easily accessible place.

4. Related Collections of Information Under Proposed Paragraph (a)(4)(vi)(B)

Under the proposed rule, a foreign broker-dealer would be exempt from the registration, reporting and other requirements of the Exchange Act to the extent that it effects transactions in securities with or for, or induces or attempts to induce the purchase or sale of any security by any U.S. person, other than a registered broker-dealer or bank acting pursuant to an exception or exemption from the definition of ''broker'' or ''dealer'' in Section 3(a)(4)(B), 3(a)(4)(E), or 3(a)(5)(C) of the Exchange Act or the rules thereunder, that acts in a fiduciary capacity for an account of a foreign resident client.[184] As a condition of this exemption, the foreign broker-dealer would be required, among other things, to obtain and maintain a representation from the U.S. person that the account is managed in a fiduciary capacity for a foreign resident client.[185]

a. Collection of Information

Proposed paragraph (a)(4)(vi)(B) would require ''collections of information'' as that term is defined in 44 U.S.C. 3502(3) in that it would require foreign broker-dealers to obtain and maintain a representation for each account managed by a U.S. fiduciary that the account is managed in a fiduciary capacity for a foreign resident client. This would require foreign broker-dealers to obtain and record each representation. The proposed paragraph would also require a collection of information by the U.S. fiduciary, which would be required to provide the representation to the foreign broker-dealer.

b. Proposed Use of Information

The collection of information in proposed paragraph (a)(4)(vi)(B) would assist foreign broker-dealers seeking to rely on the exemption under proposed paragraph (a)(4)(vi) in complying with the terms of that exemption and would provide the Commission with access to such information.

c. Respondents

As discussed above, the Commission estimates that approximately 700 foreign broker-dealers that would take advantage of either exemption under proposed paragraphs (a)(3)(iii)(A)(*1*) and (*2*).[186] The Commission believes that these estimated 700 foreign broker-dealers represent the number of foreign broker-dealers that engage in international broker-dealer business and would take advantage of the exemption in proposed paragraph (a)(4)(vi). Even though not all of these 700 foreign broker-dealers may actually utilize the exemption in proposed paragraph (a)(4)(vi), for the purposes of determining the number of foreign broker-dealer respondents for the collection of information in proposed paragraph (a)(4)(vi)(B), the Commission estimates that all 700 foreign broker-dealers that engage in international business and that would otherwise take advantage of either exemption under proposed paragraph (a)(3)(iii)(A)(*1*) or (*2*) would also utilize the exemption in proposed paragraph (a)(4)(vi) and be respondents for the purposes of the collection of information in proposed paragraph (a)(4)(vi)(B).

The Commission estimates that there are 349 U.S. fiduciaries that would be respondents for the purposes of the collection of information in proposed paragraph (a)(4)(vi)(B).

d. Reporting and Recordkeeping Burden

The Commission estimates that each U.S. fiduciary would spend approximately 5 hours per year providing representations in accordance with proposed paragraph (a)(4)(vi)(B). Therefore, the Commission estimates that the aggregate burden imposed by proposed paragraph (a)(4)(vi)(B) on all of the approximately 349 U.S. fiduciaries would be approximately 1,745 hours per year (5 hours multiplied by 349 U.S. fiduciaries).

The Commission also estimates that each foreign broker-dealer would spend approximately 5 hours per year obtaining and recording the representations required by proposed paragraph (a)(4)(vi)(B) from U.S. fiduciaries. Therefore, the Commission estimates that the aggregate burden imposed by proposed paragraph (a)(4)(vi)(B) on all the approximately 700 foreign broker-dealers would be approximately 3,500 hours per year (5 hours multiplied by 700 foreign broker-dealers).

e. Collection of Information Is Mandatory

These collections of information would be mandatory for U.S. fiduciaries and foreign broker-dealers that effect transactions according to the proposed exemption in proposed paragraph (a)(4)(vi) of the proposed rule.

f. Confidentiality

The proposed rule would require that a foreign broker-dealer maintain the representations it would obtain from a U.S. fiduciary regarding the U.S. fiduciary's accounts. All information related to transactions with qualified investors, whether kept by U.S. registered broker-dealers or foreign broker-dealers, would be subject to review and inspection by the Commission and its representatives as required in connection with examinations, investigations and enforcement proceedings. Such information is not required to be disclosed to the public and will be kept confidential by the Commission.

g. Record Retention Period

Proposed paragraph (a)(4)(vi)(B) would not include a record retention period.

5. Request for Comment

The Commission requests comment on the proposed collections of information in order to: (1) Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information would have practical utility; (2) evaluate the accuracy of the Commission's estimates of the burden of the proposed collections of information; (3) determine whether there are ways to

[184] *See* proposed paragraph (a)(4)(vi).

[185] *See* proposed paragraph (a)(4)(vi)(B).

[186] *See* note 178, *supra.*

enhance the quality, utility and clarity of the information to be collected; (4) evaluate whether there are ways to minimize the burden of the collection of information on those who respond, including through the use of automated collection techniques or other forms of information technology; and (5) evaluate whether the proposed rules would have any effects on any other collection of information not previously identified in this section.

Persons who desire to submit comments on the collection of information requirements should direct their comments to OMB, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should also send a copy of their comments to Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549–1090, and refer to File No. S7–16–08. OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication of this document in the **Federal Register**; therefore, comments to OMB are best assured of having full effect if OMB receives them within 30 days of this publication. Requests for the materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7–16–08, and be submitted to the Securities and Exchange Commission, Records Management Office, 100 F Street, NE, Washington, DC 20549–1110.

B. Consideration of Benefits and Costs

1. Expected Benefits

The proposed rule would have several important benefits. First, the proposed rule would allow a broader category of U.S. investors [187] greater access to foreign broker-dealers and foreign markets by expanding and streamlining the conditions under which a foreign broker-dealer could operate without triggering the registration requirements of Section 15(a)(1) or 15B(a)(1) of the Exchange Act. Among the benefits to U.S. investors would be expanded investment and diversification opportunities and lower cost of accessing such opportunities. Because the proposed rule would broaden the category of U.S. investors that may interact with foreign broker-dealers, the expanded investment and diversification opportunities would be available to a greater number of U.S. investors that the Commission believes possess the investment experience to effect transactions with or through unregistered broker-dealers under the safeguards imposed by the proposed rule. This also would be a benefit to foreign broker-dealers, which would have access to an expanded potential client base without being required to register with the Commission as broker-dealers.

In addition, the Commission understands that the current chaperoning requirements have been criticized as impractical and imposing unnecessary operational and compliance burdens, particularly for communications with broker-dealers in time zones outside those of the United States. In this regard, the Commission believes that the investor protections intended to be provided by the presence of associated persons of U.S. registered broker-dealers during in-person or telephonic communications between foreign associated persons of foreign broker-dealers and U.S. investors, as under the current rule, could be achieved by less operationally challenging methods. Specifically, foreign associated persons that are subject to statutory disqualification specified in Section 3(a)(39) of the Exchange Act would be precluded from contacting qualified investors and foreign broker dealers would be required to make disclosures to those investors, placing them on notice that the foreign broker-dealer is regulated by a foreign securities authority and not by the Commission and, in the case of Exemption (A)(*1*), informing them that U.S. segregation requirements, U.S. bankruptcy protections and protections under the SIPA would apply to any funds and securities held by the foreign broker-dealer.[188] Accordingly, the proposed rule would allow a foreign broker-dealer to have unchaperoned visits within the United States and communications, both oral and electronic, with qualified investors, as long as a U.S. registered broker-dealer assumes certain limited responsibilities in connection with the foreign broker-dealer's activities, as described above. As a result, the proposed rule should facilitate communications between foreign broker-dealers and qualified investors to communicate, while utilizing more efficient methods designed to protect qualified investors.

Second, the proposed rule would provide U.S. registered broker-dealers and foreign broker-dealers with greater flexibility in how they conduct business under paragraph (a)(3) of Rule 15a–6. For instance, U.S. registered broker-dealers acting under Exemption (A)(*1*) would be allowed to maintain copies of books and records in the form prescribed by the foreign securities authority and with the foreign broker-dealer. In general, the proposed rule would allow a foreign broker-dealer to effect transactions on behalf of qualified investors and custody qualified investor funds and securities relating to any resulting transactions with more limited participation in the transaction by a U.S. registered broker-dealer. Among other things, this would have the benefit of eliminating the need for the U.S. registered broker-dealer to ''double book'' transactions under current Rule 15a–6(a)(3). It would also allow the foreign broker-dealer more flexibility in how it communicates with qualified investors, as described above.

Third, while proposed Rule 15a–6 would impose certain costs on U.S. registered broker-dealers acting under either exemption, as discussed below, these costs would be markedly less than under current Rule 15a–6. Most importantly, the proposed rule would significantly reduce the cost for a U.S. registered broker-dealer to intermediate transactions under paragraph (a)(3) of Rule 15a–6.

Under Exemption (A)(*1*), the U.S. registered broker-dealer would not be required to effect transactions—and perform all of the functions associated with effecting transactions, including, for example, compliance with recording and recordkeeping rules, issuing confirmations and maintaining custody of customer funds and securities—on behalf of the qualified investor. Instead, under the proposed rule, the U.S. registered broker-dealer would only be required to collect and make available to the Commission certain limited information. Specifically, the proposed rule would require a U.S. registered broker-dealer acting under Exemption (A)(*1*) to maintain certain books and records, including confirmations and statements issued by the foreign broker-dealer to the qualified investor, but would permit the U.S. registered broker-dealer to maintain those books and records in the form, manner and for the

[187] As noted above, the proposed rule would expand the category of U.S. investors with which a foreign broker-dealer may interact under Rule 15a–6(a)(2) from major U.S. institutional investors to qualified investors and generally expand the category of U.S. investors with which a foreign broker-dealer may interact under Rule 15a–6(a)(3) from major U.S. institutional investors and U.S. institutional investors to qualified investors. This would allow foreign broker-dealers, for the first time, to interact with a corporation, company, or partnership that owns and invests on a discretionary basis $25 million or more in investments under paragraph (a)(3). In addition, under the proposed rule, natural persons who own or invest on a discretionary basis not less than $25,000,000 in investments would be included. *See* Part III.A., *supra*.

[188] *See* proposed Rule 15a–6(a)(3)(i)(B) and (D).

periods prescribed by the foreign securities authority regulating the foreign broker-dealer and with the foreign broker-dealer.[189] The Commission believes that all U.S. registered broker-dealers acting under Exemption (A)(*1*) in Rule 15a–6(a)(3) relationships would take advantage of this option, thereby significantly lowering costs associated with collecting and maintaining books and records, including collection of information burdens under the Paperwork Reduction Act and associated costs. There would also be significant cost savings for U.S. registered broker-dealers acting under Exemption (A)(*1*) because they would not have to clear and settle transactions, safeguard customer funds and securities, or issue confirmations.

In addition, regardless of whether the U.S. registered broker-dealer acts under Exemption (A)(*1*) or Exemption (A)(*2*), the proposed rule would eliminate the current rule's requirement that the U.S. registered broker-dealer make certain determinations regarding the foreign broker-dealer and its associated persons. Under the proposed rule, the U.S. registered broker-dealer would only be required to obtain representations from the foreign broker-dealer regarding that information.[190] This would be a significant cost savings with respect to the current rule because the U.S. registered broker-dealer would not have to make the determination itself for each foreign broker-dealer and its associated persons as under the current rule.

Finally, the proposed rule would reduce a foreign broker-dealer's costs of meeting the conditions of the exemption in two principal ways. First, the proposed amendments would make it less burdensome for foreign broker-dealers to communicate directly with qualified investors. Currently, Rule 15a–6 requires an associated person of a U.S. registered broker-dealer to chaperone certain in-person visits and oral communications between foreign associated persons and U.S. institutional investors, with certain exceptions, and chaperone in-person visits between foreign associated persons and major U.S. institutional investors under certain conditions.[191] The proposed rule would allow a foreign broker-dealer to hold in-person meetings and have oral and electronic communications with qualified investors without the intermediation of an U.S. registered broker-dealer. This would result in significant cost savings.

Second, the proposed rule would provide a foreign broker-dealer with the alternative of having a U.S. registered broker-dealer act under Exemption (A)(*1*) or under Exemption (A)(*2*). These alternatives would allow the foreign broker-dealer and the U.S. registered broker-dealer, as well as the qualified investors, to determine the most cost effective method for complying with the rule.

2. Expected Costs

Of course, reducing the cost of complying with paragraph (a)(3) of Rule 15a–6 may encourage more U.S. registered broker-dealers and foreign broker-dealers to rely on the rule, which would increase the overall costs associated with complying with the requirements of Rule 15a–6. As noted above, the increased flexibility of the proposed rule would provide U.S. investors with increased access to foreign broker-dealers and foreign markets, which would presumably lead to increased transactional activity under Rule 15a–6(a)(3). As a result, foreign broker-dealers may experience some incremental cost increase. In addition, because some of the responsibilities under paragraph (a)(3) of the proposed rule would be shifted to the foreign broker-dealer, foreign broker-dealers may incur some greater costs, some of which are described below. We believe these increased costs would be insignificant. For example, because foreign broker-dealers, as members of foreign exchanges, typically are required to clear and settle transactions in foreign securities, regardless of the requirements of Rule 15a–6(a)(3), shifting the responsibility for clearing and settling from the U.S. registered broker-dealer to foreign broker-dealers would not increase their cost of complying with Rule 15a–6. Similarly, other foreign governments or securities regulators may have laws or rules comparable to the provisions in Section 3(a)(39) of the Exchange Act related to statutory disqualification. Requiring foreign broker-dealers to review the fitness of their associated persons under the provisions of Section 3(a)(39), in addition to meeting the requirements of equivalent foreign laws or rules, would impose an incremental cost on those foreign broker-dealers.

Shifting some of the responsibilities under paragraph (a)(3) of the proposed rule to foreign broker-dealers would have an effect on the business activities of U.S. registered broker-dealers. For example, shifting the responsibility for clearing and settling from the U.S. registered broker-dealer to foreign broker-dealers would reduce the compensation received by U.S. registered broker-dealers for these and other services. The elimination of the chaperoning requirements of the current rule may also reduce income to U.S. registered broker-dealers that perform such services for foreign broker-dealers.

In addition, as described above, certain provisions of the proposed rule would impose "collection of information" requirements within the meaning of the Paperwork Reduction Act on foreign broker-dealers, U.S. registered broker-dealers and U.S. fiduciaries.[192] For each of the collections of information that would be imposed by the proposed rule, the relevant respondent or respondents would incur an hour burden in complying with the collection of information requirements. For example, as described above, proposed paragraph (a)(3)(i)(B) would require that a foreign broker-dealer make a determination that its foreign associated persons effecting transactions with a qualified investor are not subject to a statutory disqualification. As explained, we estimate each foreign broker-dealer that takes advantage of the exemption under the proposed rule would spend approximately 10 hours per year in making the determination required by proposed paragraph (a)(3)(i)(B). While not a burden for the purposes of the PRA, the foreign broker-dealer would also incur certain costs related to the 10 hours per year spent making the determination required by proposed paragraph (a)(3)(i)(B). Specifically, the determination likely would be made by an employee of the foreign broker-dealer to whom the broker-dealer must pay a salary or hourly wage. Therefore, the salaries and wages foreign broker-dealers, U.S. registered broker-dealers and U.S. fiduciaries must pay to the employees who would perform the work required by the collections of information imposed by the proposed rule would be additional costs of meeting the exemption in the proposed rule. These costs are described in the following paragraphs.

a. Collection of Information Costs to Foreign Broker-Dealers

As described above in the Paperwork Reduction Act Analysis, proposed paragraphs (a)(3)(i)(B), (a)(3)(i)(C), (a)(3)(i)(D), (a)(3)(iii)(C) and (a)(4)(vi)(B) each would impose collection of

[189] *See* proposed Rule 15a–6(a)(3)(iii)(A)(*1*) and (*2*).

[190] *See* proposed Rule 15a–6(a)(3)(iii)(C).

[191] *See* 17 CFR 240.15a–6(a)(3)(ii)(A)(*1*) and (iii)(B). This would be a cost savings for U.S. registered broker-dealers as well, as they would no longer need to chaperone the in-person visits and oral communications of foreign associated persons with U.S. investors.

[192] *See* Part VI.A., *supra*.

information requirements on foreign broker-dealers. Other than proposed paragraph (a)(3)(i)(C), these collections of information would require the foreign broker-dealer to make certain legal determinations, provide or obtain legal representations or draft disclosures. Therefore, the Commission believes that the type of work required by each requirement would be performed by a compliance attorney at each foreign broker-dealer. Proposed paragraph (a)(3)(i)(C), however, is a record-keeping requirement and the Commission believes that this type of work would be performed by a compliance clerk at each foreign broker-dealer.

The Commission estimates that foreign broker-dealers pay compliance attorneys at an hourly rate of (U.S.) $270.00 and compliance clerks at an hourly rate of (U.S.) $62.00.[193] Based on the estimates of the hourly burden imposed by proposed paragraphs (a)(3)(i)(B), (a)(3)(i)(B), (a)(3)(i)(D), (a)(3)(iii)(C) and (a)(4)(vi)(B) on foreign broker-dealers, the Commission further estimates that foreign broker-dealers would incur a total cost of (U.S.) $6,560.00 per year complying with the collection of information requirements that would be imposed by those paragraphs.[194]

b. Collection of Information Costs to U.S. Registered Broker-Dealers

As described above in the Paperwork Reduction Act Analysis, proposed paragraphs (a)(3)(iii)(B), (C) and (D) each would impose collection of information requirements on U.S. registered broker-dealers. These collections of information would require the U.S. registered broker-dealer to obtain and record certain legal representations made by foreign broker-dealers. The Commission believes that this type of work would be performed by a compliance attorney at each U.S. registered broker-dealer. The Commission estimates that U.S. registered broker-dealers pay compliance attorneys at an hourly rate of (U.S.) $270.00. Based on the estimates of the hourly burden imposed by proposed paragraphs (a)(3)(iii)(B), (C) and (D) on U.S. registered broker-dealers, the Commission further estimates that U.S. registered broker-dealers intermediating transactions for foreign broker-dealers relying on Exemption (A)(*1*) would incur a total cost of (U.S.) $10,800.00 per year complying with the collection of information requirements that would be imposed by those paragraphs.[195] The Commission estimates that U.S. registered broker-dealers intermediating transactions for foreign broker-dealers relying on Exemption (A)(*2*) would incur a total cost of (U.S.) $13,527.00 per year complying with the collection of information requirements that would be imposed by those paragraphs.[196]

c. Collection of Information Costs to U.S. Fiduciaries

As described above in the Paperwork Reduction Act Analysis, proposed paragraph (a)(4)(vi)(B) would impose collection of information requirements on U.S. fiduciaries in the form of a legal representation provided to foreign broker-dealers that, for each account managed by a U.S. fiduciary, the account is managed in a fiduciary capacity for a foreign resident client. The Commission believes that these legal representations would be made by a compliance attorney at each U.S. fiduciary.

The Commission estimates that U.S. fiduciaries pay compliance attorneys at an hourly rate of (U.S.) $270.00. Based on the estimates of the hourly burden imposed by proposed paragraphs (a)(4)(vi)(B) on U.S. fiduciaries, the Commission further estimates that U.S. fiduciaries would incur a total cost of (U.S.) $1,350.00 per year complying with the collection of information requirements that would be imposed by that paragraph (5 hours per year at $270.00 per hour = $1,350.00 per year).[197]

3. Comment Solicited

We solicit comment on the costs and benefits to U.S. investors, foreign broker-dealers, U.S. registered broker-dealers and others who may be affected by the proposed amendments to Rule 15a–6. We request views on the costs and benefits described above as well as on any other costs and benefits that could result from adoption of the proposed rule amendments. The Commission renews its request for comment on the Commission's estimates of the hour burdens that would be imposed by the collections of information in the proposed rule and also solicits comment on its calculation of the monetary cost of those burdens. In particular, the Commission requests comment on whether the work required by the collections of information would be performed by the individuals identified. For the cost of work that would be performed by employees of foreign broker-dealers, is it reasonable to assume that such employees generally earn salaries and wages similar to comparable employees of U.S. registered broker-dealers, after conversion to U.S. dollars? Commenters are requested to provide empirical data and other factual support for their views, if possible.

C. Consideration of Burden on Competition, and on Promotion of Efficiency, Competition and Capital Formation

Section 3(f) of the Exchange Act requires the Commission, whenever it engages in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, to consider whether the action would promote efficiency, competition and capital formation.[198] Exchange Act Section 23(a)(2) requires the Commission, in making rules under the Exchange Act, to consider the impact that any such rule would have on competition. This section also prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.[199]

The Commission believes the proposed amendments would not impose any burden on competition not necessary or appropriate in furtherance of the Exchange Act. By streamlining the conditions under which a foreign broker-dealer may operate without

[193] *See* Securities Industry and Financial Markets Association's ''Management & Professional Earnings in the Securities Industry—2007'' (available at: *http://www.sifma.org/research/surveys/professional-earning.shtml*). The SIFMA study reflects a survey of U.S. earnings. We estimate that the earnings of comparable employees at foreign broker-dealers are similar, but solicit comment on whether foreign salaries vary and, if so, how.

[194] 10 hours per year at $270.00 per hour complying with proposed paragraph (a)(3)(i)(B), 10 hours per year at $62.00 per hour complying with proposed paragraph (a)(3)(i)(C), 2 hours per year at $270.00 per hour complying with proposed paragraph (a)(3)(i)(D), 5 hours per year at $270.00 per hour complying with proposed paragraph (a)(3)(iii)(C) and 5 hours per year at $270.00 per hour complying with proposed paragraph (a)(4)(vi)(B). *See* Part VI.A., *supra.*

[195] 5 hours per year at $270.00 per hour and 35 hours per year at $270.00 per hour. *See id.*

[196] 8 hours per year at $270.00 per hour and 50.1 hours per year at $270.00 per hour. *See id.* As discussed above in the PRA analysis, U.S. registered broker-dealers intermediating transactions for foreign broker-dealers relying on Exemption (A)(*1*) would spend different amounts of time complying with the collection of information requirements of proposed paragraphs (a)(3)(iii)(B), (C) and (D) than U.S. registered broker-dealers intermediating transactions for foreign broker-dealers relying on Exemption (A)(*2*). *See* Part VI.A., *supra.* Therefore, the monetary costs incurred in complying with these paragraphs would also be different for intermediating U.S. registered broker-dealers, depending on the exemption relied upon by the foreign broker-dealer. *See id.*

[197] *See id.*

[198] 15 U.S.C. 78c(f).

[199] 15 U.S.C. 78w(a)(2).

triggering the registration requirements of Section 15(a)(1) or 15B(a)(1) of the Exchange Act and the reporting and other requirements of the Exchange Act (other than Sections 15(b)(4) and 15(b)(6)), the proposed amendments to Rule 15a–6 should promote competition by enhancing the ability of foreign broker-dealers to compete with U.S. registered broker-dealers in the U.S. market, particularly with respect to transactions in foreign securities.[200]

We note, in particular, that making Exemption (A)(1) available only to a foreign broker-dealer conducting a predominantly foreign business would provide U.S. investors increased access to foreign expertise and foreign securities and markets without creating opportunities for regulatory arbitrage vis-à-vis U.S. securities markets.[201] As discussed above, this is particularly important because, under Exemption (A)(1), for the first time, a foreign broker-dealer would be able to provide full-service brokerage services (including maintaining custody of funds and securities from resulting transactions) to U.S. investors.[202] We are proposing an 85 percent threshold for determining whether a foreign broker-dealer conducts a predominantly foreign business because a lower threshold may allow a foreign broker-dealer to conduct significant business in U.S. securities with U.S. investors without being regulated by the Commission. While we believe that the 85% threshold would be effective in eliminating the opportunities for regulatory arbitrage, allowing foreign broker-dealers to conduct any business in U.S. securities could affect the competitive positions of U.S. registered broker-dealers and foreign broker-dealers.[203]

Exemption (A)(*2*), which would not require a foreign broker-dealer to conduct a predominantly foreign business, would allow foreign broker-dealers to compete more directly with U.S. registered broker-dealers without limitation on the type of security, U.S. or foreign. In order to preserve measures of investor protection, however, the proposed rule would require a U.S. registered broker-dealer to keep books and records and act as custodian of funds and securities.[204]

We solicit comment on whether the proposed amendments would promote competition, including whether investors would be more or less likely to choose to invest in foreign markets under the proposed rule.

The Commission also believes the proposed amendments would promote efficiency. As U.S. investors increasingly invest in securities whose primary market is outside the United States, the ability of these investors to obtain ready access to foreign markets has grown in importance.[205] In some cases, foreign broker-dealers may offer such access to these U.S. investors by more efficient means than a U.S. registered broker-dealer could. For example, a foreign broker-dealer may more efficiently provide a U.S. investor with the means to execute trades quickly in a wide range of foreign securities markets. A foreign broker-dealer may also offer expertise and access to research reports concerning foreign companies, industries and market environments.[206] Allowing foreign broker-dealers to provide these services to certain classes of U.S. investors without registering, but subject to the conditions of proposed Rule 15a–6, would further stimulate the competition and efficiencies promoted by the current rule.

The proposed amendments to Rule 15a–6 are intended to promote efficiency by reducing the costs of compliance for both U.S. registered broker-dealers and foreign broker-dealers conducting transactions pursuant to paragraph (a)(3). As discussed above, the proposed rule should decrease the burden on U.S. registered broker-dealers acting under both Exemption (A)(*1*) and Exemption (A)(*2*) for foreign broker-dealers. While some of this burden would be shifted to foreign broker-dealers, overall the burden of complying with the proposed rule would be lessened. As a result, we believe that the proposed rule would enable U.S. investors to more efficiently gain access to foreign broker-dealers.

Although the proposed amendments may facilitate capital formation and capital raising by foreign broker-dealers by increasing the available pool of U.S. investors foreign broker-dealers can contact directly, the Commission does not believe that they would have any significant effect on capital formation. We note that U.S. investors can currently obtain access to foreign securities through U.S. broker-dealers.

We solicit comment on whether the proposed amendments would impose a burden on competition or whether they would promote efficiency, competition and capital formation. Commenters are requested to provide empirical data and other factual support for their views if possible.

D. Consideration of the Impact on the Economy

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or ''SBREFA,'' [207] the Commission must advise the Office of Management and Budget as to whether the proposed amendments to Rule 15a–6 constitute a ''major'' rule. Under SBREFA, a rule is considered ''major'' where, if adopted, it would result or is likely to result in: An annual effect on the economy of $100 million or more (either in the form of an increase or a decrease); a major increase in costs or prices for consumers or individual industries; or a significant adverse effect on competition, investment, or innovation.

If a rule is ''major,'' its effectiveness would generally be delayed for 60 days pending Congressional review. We request comment on the potential impact of the proposed amendments on the economy on an annual basis. Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

E. Regulatory Flexibility Certification

Section 3(a) of the Regulatory Flexibility Act (''RFA'') requires the Commission to undertake an initial regulatory flexibility analysis of the impact of a proposed rule on small entities, unless the Commission certifies that the rule, if adopted, would not have a significant economic impact on a substantial number of small entities. The application of the RFA to proposed Rule 15a–6 is limited, because its exemptive provisions would be restricted to foreign broker-dealers, which need not be considered under the RFA. In addition, to the extent that the proposed rule, if adopted, would impose any costs on U.S. registered broker-dealer affiliates of such foreign broker-dealers or on other domestic broker-dealers, those costs are not significant and would not impact a substantial number of small domestic broker-dealers. Staff discussions with industry have indicated that small domestic broker-dealers generally are not engaged in Rule 15a–6(a)(3) arrangements with foreign broker-dealers, and have not indicated that this would change in the event the conditions of the rule were amended. Accordingly, the Commission certifies that the proposed rule, if adopted, would not have a significant economic

[200] *See* generally, Part III.D.1., *supra*.

[201] *See* Part III.D.1.a., *supra*.

[202] *See id.*

[203] *See* Part III.D.1.a.ii., *supra*.

[204] *See* Part III.D.1.b.i., *supra*.

[205] *See* Part III.A., *supra*.

[206] *See generally,* Part III.D.1., *supra*.

[207] Pub. L. 104–121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C., 15 U.S.C. and as a note to 5 U.S.C. 601).

impact on a substantial number of small entities.

VII. Statutory Basis

Pursuant to the Exchange Act and particularly sections 3, 10, 15, 17, 23, 30 and 36 thereof, 15 U.S.C. 78c, 78j, 78o, 78q, 78w, 78dd and 78mm, the Commission proposes to amend § 240.15a–6 of Title 17 of the Code of Federal Regulations in the manner set forth below.

VIII. Text of Proposed Amendments

Lists of Subjects in 17 CFR Part 240

Broker-dealers, Reporting and recordkeeping requirements, Securities.

In accordance with the foregoing, Title 17, Chapter II of the Code of Federal Regulations is proposed to be amended as follows:

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

1. The authority citation for part 240 continues to read in part as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z–2, 77z–3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j–1, 78k, 78k–1, 78*l*, 78m, 78n, 78o, 78p, 78q, 78s, 78u–5, 78w, 78x, 78*ll*, 78mm, 80a–20, 80a–23, 80a–29, 80a–37, 80b–3, 80b–4, 80b–11 and 7201 *et seq.*; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

2. Revise § 240.15a–6 to read as follows:

§ 240.15a–6 Exemption of certain foreign brokers or dealers.

(a) A foreign broker or dealer shall be exempt from the registration requirements of sections 15(a)(1) and 15B(a)(1) of the Act and the reporting and other requirements of the Act (other than sections 15(b)(4) and 15(b)(6)), and the rules and regulations thereunder, that apply specifically to a broker or dealer that is not registered with the Commission solely by virtue of its status as a broker or dealer, with respect to a particular transaction or solicitation, to the extent that the foreign broker or dealer operates in compliance with paragraph (a)(1), (a)(2), (a)(3), (a)(4) or (a)(5) of this section with respect to such transaction or solicitation.

(1) *Unsolicited trades.* The foreign broker or dealer effects transactions in securities with or for persons that have not been solicited by the foreign broker or dealer.

(2) *Research reports.* The foreign broker or dealer furnishes research reports to qualified investors, and effects transactions in the securities discussed in the research reports with or for those qualified investors, provided that the following conditions are satisfied:

(i) The research reports do not recommend the use of the foreign broker or dealer to effect trades in any security;

(ii) The foreign broker or dealer does not initiate contact with those qualified investors to follow up on the research reports, and does not otherwise induce or attempt to induce the purchase or sale of any security by those qualified investors;

(iii) If the foreign broker or dealer has a relationship with a registered broker or dealer that satisfies the requirements of paragraph (a)(3) of this section, any transactions with the foreign broker or dealer in securities discussed in the research reports are effected pursuant to the provisions of paragraph (a)(3) of this section; and

(iv) The foreign broker or dealer does not provide research to U.S. persons pursuant to any express or implied understanding that those U.S. persons will direct commission income to the foreign broker or dealer.

(3) *Solicited trades.* The foreign broker or dealer induces or attempts to induce the purchase or sale of any security by a qualified investor, provided that the following conditions are satisfied:

(i) The foreign broker or dealer:

(A) Provides the Commission (upon request or pursuant to agreements reached between any foreign securities authority and the Commission or the U.S. government) with any information or documents within the possession, custody, or control of the foreign broker or dealer, any testimony of foreign associated persons, and any assistance in taking the evidence of other persons, wherever located, that the Commission requests and that relates to transactions under paragraph (a)(3) of this section, except that if, after the foreign broker or dealer has exercised its best efforts to provide the information, documents, testimony, or assistance, including requesting the appropriate governmental body and, if legally necessary, its customers (with respect to customer information) to permit the foreign broker or dealer to provide the information, documents, testimony, or assistance to the Commission, the foreign broker or dealer is prohibited from providing this information, documents, testimony, or assistance by applicable foreign law or regulations, then this paragraph (a)(3)(i)(A) shall not apply and the foreign broker or dealer will be subject to paragraph (c) of this section;

(B) Determines that the foreign associated person of the foreign broker or dealer effecting transactions with the qualified investor is not subject to a statutory disqualification specified in section 3(a)(39) of the Act;

(C) Has in its files, and will make available upon request by a registered broker or dealer satisfying the requirements described in paragraph (a)(3)(iii) of this section or the Commission, the types of information specified in § 240.17a–3(a)(12), provided that the information required by paragraph (a)(12)(i)(D) of § 240.17a–3 shall include sanctions imposed by foreign securities authorities, foreign exchanges, or foreign associations, including without limitation those described in section 3(a)(39) of the Act; and

(D) Discloses to the qualified investor:

(*1*) That the foreign broker or dealer is regulated by a foreign securities authority and not by the Commission; and

(*2*) Solely when the foreign broker or dealer is relying on paragraph (a)(3)(iii)(A)(*1*) of this section, that U.S. segregation requirements, U.S. bankruptcy protections and protections under the Securities Investor Protection Act will not apply to any funds or securities held by the foreign broker or dealer;

(ii) The foreign associated person of the foreign broker or dealer effecting transactions with the qualified investor conducts all securities activities from outside the United States, except that the foreign associated person may conduct visits to qualified investors within the United States, provided that transactions in any securities discussed during visits by the foreign associated person with qualified investors are effected pursuant to paragraph (a)(3) of this section; and

(iii) A registered broker or dealer:

(A) Is responsible for either:

(*1*) Maintaining copies of all books and records, including confirmations and statements issued by the foreign broker or dealer to the qualified investor, relating to any resulting transactions, except that such books and records may be maintained:

(*i*) In the form, manner and for the periods prescribed by the foreign securities authority regulating the foreign broker or dealer; and

(*ii*) With the foreign broker or dealer, provided that the registered broker or dealer makes a reasonable determination that copies of any or all of such books and records can be furnished promptly to the Commission, and promptly provides to the Commission any such books and records, upon request; or

(*2*) (*i*) Maintaining books and records, including copies of all confirmations issued by the foreign broker or dealer to the qualified investor, relating to any resulting transactions; and

(*ii*) Receiving, delivering and safeguarding funds and securities in connection with the transactions on behalf of the qualified investor in compliance with § 240.15c3–3;

(B) Obtains from the foreign broker or dealer and each foreign associated person written consent to service of process for any civil action brought by or proceeding before the Commission or a self-regulatory organization (as defined in section 3(a)(26) of the Act), providing that process may be served on them by service on the registered broker or dealer in the manner set forth on the registered broker's or dealer's current Form BD (17 CFR 249.501);

(C) Obtains from the foreign broker or dealer a representation that the foreign broker or dealer has complied with the requirements of paragraphs (a)(3)(i)(B) and (C) of this section; and

(D) Maintains records of the written consents required by paragraph (a)(3)(iii)(B) and the representations required by paragraph (a)(3)(iii)(C) of this section, and makes these records available to the Commission upon request.

(4) *Counterparties and specific customers.* The foreign broker or dealer effects transactions in securities with or for, or induces or attempts to induce the purchase or sale of any security by:

(i) A registered broker or dealer, whether the registered broker or dealer is acting as principal for its own account or as agent for others, or a bank acting pursuant to an exception or exemption from the definition of ''broker'' or ''dealer'' in section 3(a)(4)(B), 3(a)(4)(E), or 3(a)(5)(C) of the Act or the rules thereunder;

(ii) The African Development Bank, the Asian Development Bank, the Inter-American Development Bank, the International Bank for Reconstruction and Development, the International Monetary Fund, the United Nations and their agencies, affiliates and pension funds;

(iii) 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;

(iv) Any agency or branch of a U.S. person permanently located outside the United States, provided that the transactions occur outside the United States;

(v) U.S. citizens resident outside the United States, provided that the transactions occur outside the United States, and that the foreign broker or dealer does not direct its selling efforts toward identifiable groups of U.S. citizens resident abroad; or

(vi) Any U.S. person, other than a registered broker or dealer or a bank acting pursuant to an exception or exemption from the definition of ''broker'' or ''dealer'' in section 3(a)(4)(B), 3(a)(4)(E), or 3(a)(5)(C) of the Act or the rules thereunder, that acts in a fiduciary capacity for an account of a foreign resident client, provided the foreign broker or dealer:

(A) Only effects transactions in securities with or for, or induces or attempts to induce the purchase or sale of securities by, the U.S. person in the U.S. person's capacity as a fiduciary to an account of a foreign resident client; and

(B) Obtains and maintains a representation from the U.S. person that the account is managed in a fiduciary capacity for a foreign resident client.

(5) *Familiarization with foreign options exchanges.* The foreign broker or dealer effects transactions in options on foreign securities listed on a foreign options exchange of which it is a member for a qualified investor that has not been solicited by the foreign broker or dealer, except that:

(i) A representative of the foreign options exchange located in a foreign office or a representative office in the United States may:

(A) Communicate with persons that the representative of the foreign options exchange reasonably believes are qualified investors, including through participation in programs and seminars in the United States, regarding the foreign options exchange, the options on foreign securities traded on the foreign options exchange and, if applicable, the foreign options exchange's OTC options processing service;

(B) Provide persons that the representative of the foreign options exchange reasonably believes are qualified investors with a disclosure document that provides an overview of the foreign options exchange and the options on foreign securities traded on that exchange, including the differences from standardized options in the U.S. options market and special factors relevant to transactions by U.S. persons in options on the foreign options exchange; and

(C) Make available to persons that the representative of the foreign options exchange reasonably believes are qualified investors, solely upon request of the investor, a list of participants on the foreign options exchange permitted to take orders from the public and any registered broker or dealer affiliates of such participants;

(ii) The foreign broker or dealer may:

(A) Make available to qualified investors the foreign options exchange's OTC options processing service; and

(B) Provide qualified investors, in response to an unsolicited inquiry concerning options on foreign securities traded on the foreign options exchange, with a disclosure document that provides an overview of the foreign options exchange and the options on foreign securities traded on that exchange, including the differences from standardized options in the U.S. domestic options market and special factors relevant to transactions by U.S. persons in options on that exchange; and

(iii) The foreign exchange may make available to qualified investors through the foreign broker or dealer the foreign options exchange's OTC options processing service.

(b) *Definitions.* When used in this section:

(1) The term *foreign associated person* shall mean any natural person domiciled outside the United States who is an associated person, as defined in section 3(a)(18) of the Act, of the foreign broker or dealer and who participates in the solicitation of a qualified investor under paragraph (a)(3) of this section.

(2) The term *foreign broker or dealer* shall 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 section) 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 those of a ''broker'' or ''dealer,'' as defined in section 3(a)(4) or 3(a)(5) of the Act, and that:

(i) Solely for purposes of paragraph (a)(3) of this section, is regulated for conducting securities activities, including the specific activities in which the foreign broker or dealer engages with the qualified investor, in a foreign country by a foreign securities authority; and

(ii) Solely for purposes of paragraphs (a)(3)(iii)(A)(*1*) and (a)(4)(vi) of this section, conducts a foreign business.

(3) The term *foreign business* shall 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 transactions conducted pursuant to both paragraphs (a)(3) and (a)(4)(vi) of this section 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 calculation made for the prior year for the first 60 days of a new year.

(4) The term *foreign resident client* shall 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.

(5) The term *foreign security* shall mean:

(i) An equity security (as defined in 17 CFR 230.405) of a foreign private issuer (as defined in 17 CFR 230.405);

(ii) A debt security (as defined in 17 CFR 230.902) of a foreign private issuer (as defined in 17 CFR 230.405);

(iii) A debt security (as defined in 17 CFR 230.902) issued by an issuer organized or incorporated in the United States in connection with a distribution conducted solely outside the United States pursuant to Regulation S (17 CFR 230.903);

(iv) A security that is a note, bond, debenture or evidence of indebtedness issued or guaranteed by a foreign government (as defined in 17 CFR 230.405) that is eligible to be registered with the Commission under Schedule B of the Securities Act of 1933; and

(v) A derivative instrument on a security described in paragraph (b)(5)(i), (b)(5)(ii), (b)(5)(iii), or (b)(5)(iv) of this section.

(6) The term *OTC options processing service* shall mean a mechanism for submitting an options contract on a foreign security that has been negotiated and completed in an over-the-counter transaction to a foreign options exchange so that the foreign options exchange may replace that contract with an equivalent standardized options contract that is listed on the foreign options exchange and that has the same terms and conditions as the over-the-counter options.

(7) The term *registered broker or dealer* shall mean a person that is registered with the Commission under section 15(b), 15B(a)(2), or 15C(a)(2) of the Act.

(8) The term *United States* shall mean the United States of America, including the States and any territories and other areas subject to its jurisdiction.

(c) *Withdrawal of exemption.* The Commission, by order after notice and opportunity for hearing, may withdraw the exemption provided in paragraph (a)(3) of this section with respect to the subsequent activities of a foreign broker or dealer or class of foreign brokers or dealers conducted from a foreign country, if the Commission finds that the laws or regulations of that foreign country have prohibited the foreign broker or dealer, or one of a class of foreign brokers or dealers, from providing, in response to a request from the Commission, information or documents within its possession, custody, or control, testimony of foreign associated persons, or assistance in taking the evidence of other persons, wherever located, related to activities exempted by paragraph (a)(3) of this section.

Dated: June 27, 2008.

By the Commission.

Florence E. Harmon,

Acting Secretary.

[FR Doc. E8–15000 Filed 7–7–08; 8:45 am]

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

DIVISION OF
[MARK]ET REGULATION

April 9, 1997

Giovanni P. Prezioso, Esq.
Cleary, Gottlieb, Steen & Hamilton
1752 N Street, N.W.
Washington, D.C. 20036-2806

Re: Securities Activities of U.S.-Affiliated Foreign Dealers

Dear Mr. Prezioso:

This letter responds to your letter dated March 24, 1997, on behalf of nine U.S. registered broker-dealers (the "Firms")[1] in which you request assurances that the staff will not recommend enforcement action to the Commission against any of the Firms or any foreign broker or dealer affiliated with any of the Firms (a "U.S.-Affiliated Foreign Dealer") if any of the U.S.-Affiliated Foreign Dealers engages in the securities activities described in your letter without registering as a "broker" or "dealer" under Section 15 of the Securities Exchange Act of 1934 ("Exchange Act") in reliance on the exemption from broker-dealer registration in Exchange Act Rule 15a-6.

As you note in your letter, in the years since the Commission adopted Rule 15a-6, internationalization of the securities markets has continued to accelerate. One result is that U.S. and foreign securities firms compete with one another to offer a wide range of financial products and services to their customers. In addition, institutional investors have taken a global approach in formulating their investment strategies. Moreover, the expanded use of

[1] The Firms are Bear Stearns & Co. Inc.; Credit Suisse First Boston Corporation; CSFP Capital, Inc.; Goldman, Sachs & Co.; Lehman Brothers Inc.; Merrill Lynch, Pierce, Fenner & Smith, Incorporated; Morgan Stanley & Co. Incorporated; Salomon Brothers Inc; and Smith Barney Inc.

electronic communication technology has facilitated the dissemination of securities-related information and cross border trading activity, further developing the interrelationship between U.S. and foreign markets. You request relief from the staff on a number of specific aspects of Rule 15a-6 that you believe pose significant obstacles to the effective operation of international securities activities by U.S. broker-dealers and their foreign affiliates.[2]

I. Expanded Definition of "Major U.S. Institutional Investor"

Rule 15a-6, among other things, permits foreign broker-dealers to conduct certain securities activities with "U.S. institutional investors" and "major U.S. institutional investors," as those terms are defined in the Rule, provided that those foreign broker-dealers conduct those activities in conformity with the provisions of Rule 15a-6. These definitions do not include U.S. business corporations and partnerships, nor do they permit investment funds to qualify as major U.S. institutional investors if they are advised by investment managers that are exempt from registration under the Investment Advisers Act of 1940. It is your belief that these investors may have financial wherewithal comparable to that of institutional investors covered by the Rule, and that the Rule's failure to include these investors within the definitional criteria set forth in the Rule severely constrains the utility of the Rule 15a-6 exemption.

As a result, you request the staff to provide no-action relief that will permit U.S.-Affiliated Foreign Dealers to expand the range of U.S. investors with which they may enter into securities transactions in reliance on paragraph (a)(3) of Rule 15a-6. Specifically, you request that the staff grant no-action relief that will permit, on the same basis as permitted

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[2] You note that comparable issues arise in connection with the registration requirements for foreign government securities brokers or dealers under the Government Securities Act of 1986, codified at Section 15C of the Exchange Act. The Department of the Treasury, pursuant to its authority under Exchange Act Section 15C(a)(5), has adopted an exemptive rule that largely parallels Rule 15a-6. See 17 C.F.R. § 401.9. Accordingly, pursuant to 17 C.F.R. § 400.2(d), you request that any no-action or interpretive relief granted by the staff in response to this request with respect to the application of Section 15(a) of the Exchange Act and Rule 15a-6 also apply equally with respect to the entities that are subject to 17 C.F.R. § 401.9.

for transactions with "major U.S. institutional investors" under Rule 15a-6, a U.S.-Affiliated Foreign Dealer to enter into transactions with 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 (i.e., cash, money-market instruments, securities of unaffiliated issuers, futures and options on futures and other derivative instruments).[3]

II. Direct Transfer of Funds and Securities Between U.S. Investors and U.S.-Affiliated Foreign Dealers

You also request relief from a provision of Rule 15a-6(a)(3) that requires a U.S. registered broker-dealer to intermediate transactions between U.S.-Affiliated Foreign Dealers and U.S. institutional investors and major U.S. institutional investors. In particular, you note that paragraph (a)(3)(iii)(A)(6) of Rule 15a-6 requires that a U.S. broker-dealer intermediary be responsible for receiving, delivering, and safeguarding funds and securities in connection with transactions between U.S.-Affiliated Foreign Dealers and U.S. institutional investors and major U.S. institutional investors in compliance with Rule 15c3-3 under the Exchange Act. It is your contention that Rule 15a-6(a)(3)(iii)(A)(6) is unclear in circumstances where a U.S. investor and a foreign broker-dealer wish to settle a securities transaction intermediated by a U.S. broker-dealer involving the direct transfer of funds and securities. In particular, you note that questions have arisen regarding whether, under the Rule, the clearance and settlement of all such transfers must be effected through the accounts of the U.S. broker-dealer intermediating the transaction.

Interposition of a U.S. broker-dealer in the clearance and settlement process, you contend, causes a significant duplication of functions by the U.S. broker-dealer and foreign broker-dealer, including effecting duplicate transfers of funds and securities. You argue that

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[3] You note that the asset test would be calculated on a gross basis, without deduction for liabilities of the institution, based on the balance sheet or comparable financial statement of the institution prepared in the ordinary course of its business. You also note that the requested relief in this context would apply to transactions in U.S. and foreign securities.

this duplication of functions is inefficient and increases the risk of operational errors and settlement failure. As a result, you ask the staff to confirm that in transactions involving foreign securities[4] or U.S. Government securities intermediated by a U.S. broker-dealer under Rule 15a-6, clearance and settlement may occur through the direct transfer of funds and securities between a U.S. investor and a foreign broker-dealer in situations where the foreign broker-dealer is not acting as custodian of the funds or securities of the U.S. investor. For such transactions in such securities the U.S. investor or its custodian could transfer funds or such securities directly to the foreign broker-dealer or its agent and the foreign broker-dealer or its agent could transfer any funds or such securities directly to the U.S. investor or its custodian. This requested relief would apply only in circumstances where (1) the foreign broker-dealer agrees to make available to the intermediating U.S. broker-dealer clearance and settlement information relating to such transfers and (2) the foreign broker-dealer is not in default to any counterparty on any material financial market transaction. Moreover, the requested relief would apply solely to the operational issue of the transfer of funds and securities between a foreign broker-dealer and a U.S. institutional investor or major U.S. institutional investor (including those investors with which a U.S.-Affiliated Foreign Dealer would be able to enter into transactions pursuant to the relief you request in Part II.A of your letter) in the context of clearance and settlement of transactions in foreign securities or U.S. Government securities between that foreign broker-dealer and that U.S. investor where the foreign broker-dealer is not acting as custodian for the U.S. investor.

You note that the granting of such relief should not be construed to suggest that the staff has made any implicit or explicit determinations regarding the permissibility of any particular transaction or custodial arrangement related to such a transfer. In this regard, you acknowledge that the foreign broker-dealer would continue to be required to ensure that each

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[4] You use the term "foreign securities" as defined in your previous correspondence relating to Rule 15a-6. See Cleary, Gottlieb, Steen & Hamilton (November 22, 1995, revised January 30, 1996).

such transaction and any custodial arrangement qualifies in all other respects for exemption under the Rule, even though the direct transfer of funds and securities would be permitted to occur as described above. Finally, you note that the intermediating U.S. broker-dealer would fulfill all of the other enumerated duties under paragraph (a)(3)(iii)(A) of the Rule, including effecting the transactions, issuing required confirmations and maintaining required books and records relating to the transactions.

III. Permissible Contacts with U.S. Investors by Foreign Associated Persons of U.S.-Affiliated Foreign Dealers

You also request relief from the provisions of Rule 15a-6 that require an associated person of a U.S. broker-dealer intermediary to participate in certain communications between foreign associated persons of a foreign broker-dealer and certain U.S. investors. In particular, you note that paragraph (a)(3)(iii)(B) of Rule 15a-6 requires that an associated person of the U.S. broker-dealer intermediary participate in all oral communications between foreign associated persons and U.S. institutional investors other than major U.S. institutional investors, and that paragraph (a)(3)(ii)(A)(1) of Rule 15a-6 requires participation by an associated person of the U.S. broker-dealer intermediary in connection with visits in the United States by a foreign associated person with both U.S. institutional investors and major U.S. institutional investors.

1. Chaperoning Requirements

You argue that these "chaperoning" requirements have proven awkward to implement in practice, particularly in the context of those markets that are separated from the U.S. by a large number of time zones. You contend that they also provide only slight policy benefits in light of the experience and capabilities of the U.S. institutional investors eligible to enter into transactions under paragraph (a)(3) of Rule 15a-6 and the other investor protections provided by the Rule, such as the requirement that the foreign associated person not be subject to a statutory disqualification as defined in Section 3(a)(39) of the Exchange Act.

Accordingly, you request that the staff grant no-action relief that would permit foreign associated persons of a U.S.-Affiliated Foreign Dealer, without the participation of an

associated person of an affiliated Firm,[5] to: (1) engage in oral communications from outside the United States with U.S. institutional investors where such communications take place outside of the trading hours of the New York Stock Exchange (i.e., at present, 9:30 a.m. to 4:00 p.m. New York Time), so long as the foreign associated persons do not accept orders to effect transactions other than those involving foreign securities (as defined in note 5 of your letter) and (2) have in-person contacts during visits to the United States with major U.S. institutional investors (including those investors with which a U.S.-Affiliated Foreign Dealer would be able to enter into transactions pursuant to the relief requested in Part II.A of your 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 United States.[6]

2. Electronic Quotation Systems

In addition, you seek relief with respect to the U.S. distribution of foreign broker-dealers' quotations. In the release adopting Rule 15a-6, the Commission indicated that the Rule "generally would permit the U.S. distribution of foreign broker-dealers' quotations by third party systems...that distributed these quotations primarily in foreign countries" provided that the third-party systems did not allow securities transactions to be executed between the

[5] As you note, foreign associated persons of the U.S.-Affiliated Foreign Dealers could continue to have "unchaperoned" contacts with U.S. persons at any time if they are dually employed or "two-hatted" (i.e., also qualified as registered representatives acting on behalf of and under the supervision of an affiliated Firm under U.S. self-regulatory organization guidelines).

[6] As you request, the staff is clarifying 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 (including those entities qualifying pursuant to the relief you request in Part II.A of your letter) 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.

foreign broker-dealer and persons in the U.S. through the systems.[7] In other words, in the absence of other contacts with U.S. investors initiated by the third party systems, distribution of such quotes by such systems would not be considered to be a form of solicitation.[8] Because third-party quotation services have become increasingly global in scope since Rule 15a-6 was adopted, it is your view that the distinction between systems that distribute quotations primarily in the U.S. and those that distribute quotations primarily in foreign countries is no longer a useful regulatory dividing line. As a result, as you request, the staff is clarifying that the interpretive portions of the Adopting Release requiring operation of quotation systems by third parties that primarily distribute foreign broker-dealers' quotations (including prices and other trade-reporting information input directly by foreign broker-dealers) in foreign countries no longer apply.

With respect to proprietary quotation systems, you highlight a passage from the Adopting Release where the Commission noted that "the direct dissemination of a foreign market maker's quotations to U.S. investors, such as through a private quote system controlled by a foreign broker-dealer would not be appropriate without registration, because the dissemination of these quotations would be a direct, exclusive inducement to trade with that foreign broker-dealer." You note, however, that there is no express indication that the Commission's position in the Adopting Release is intended to preclude a foreign broker-dealer from directly inducing U.S. investors to trade with the foreign broker-dealer via a quotation system where the U.S. investor subscribes to the quotation system through a U.S. broker-dealer, the U.S. broker-dealer has continuing access to the quotation system, and the foreign broker-dealer's other contacts with U.S. investors are permissible under Rule 15a-6.

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[7] See Exchange Act Release No. 27017 (July 11, 1989), 54 FR 30,013 (July 18, 1989) ("Adopting Release").

[8] As the Commission stated in the Adopting Release, however, foreign broker-dealers whose quotes were distributed through such systems would not be allowed to initiate contacts with U.S. persons "beyond those exempted under the Rule, without registration or further exemptive rulemaking."

In this regard, as you request, the staff is confirming that providing U.S. investors with access to screen-based quotation systems that supply quotations, prices and other trade-reporting information input directly by foreign broker-dealers will not constitute an impermissible contact with a foreign broker-dealer, so long as any transactions between the U.S. investor and the foreign broker-dealer are intermediated in accordance with the requirements of Rule 15a-6. As you note, a foreign broker-dealer that directs quotations to U.S. investors through a proprietary system (as distinct from a third-party system) would be viewed as having "solicited" any resulting transactions (and thus could not rely on the exemption in paragraph (a)(1) of Rule 15a-6), although it would continue to be allowed to effect transactions in reliance on other available provisions of the Rule.

Response:

While not necessarily agreeing or disagreeing with the reasoning contained in your letter, based on the facts and representations presented, the staff of the Division of Market Regulation will not recommend enforcement action to the Commission under Section 15(a) of the Exchange Act against any of the Firms (or a similarly situated U.S. registered broker-dealer), any U.S.-Affiliated Foreign Dealer (or a similarly situated foreign broker-dealer) if any of the U.S.-Affiliated Foreign Dealers (or a similarly situated foreign broker-dealer) engages in the securities activities described in your letter without registering as a "broker" or "dealer" under Section 15 of the Exchange Act.[9]

This letter represents the views of the Division based on our understanding of the proposed activities of the U.S.-Affiliated Foreign Dealers as discussed in your letter. This staff position concerns enforcement action only and does not represent a legal conclusion regarding the applicability of the statutory or regulatory provisions of the federal securities laws. Moreover, this position is based solely on the representations that you have made, and

[9] Consultations with staff of the Department of the Treasury have affirmed that this relief applies equally with respect to those entities that are subject to 17 C.F.R. § 401.9. See note 2 above.

any different facts or conditions might require a different response.

Sincerely,

Richard R. Lindsey
Director

cc: Roger Anderson
Deputy Assistant Secretary for Federal Finance
Department of the Treasury

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*NOT ADMITTED IN THE DISTRICT OF COLUMBIA

Securities Exchange Act of 1934
Section 15(a); Rule 15a-6

March 24, 1997

Office of Chief Counsel

MAR 26 1997

Division of Market Regulati[illegible]

VIA HAND DELIVERY

Mr. Richard R. Lindsey
Director, Division of Market Regulation
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Re: Request for No-Action and Interpretive Relief Relating to Certain Securities Activities of U.S.-Affiliated Foreign Dealers

Dear Mr. Lindsey:

We are writing on behalf of our clients, listed in note 1 of this letter,[1] to request your advice that the staff would not recommend that the Securities and Exchange Commission (the "Commission") take any enforcement action against any of the Firms or any

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1 Bear, Stearns & Co. Inc.; Credit Suisse First Boston Corporation; CSFP Capital, Inc.; Goldman, Sachs & Co.; Lehman Brothers Inc.; Merrill Lynch, Pierce, Fenner & Smith, Incorporated; Morgan Stanley & Co. Incorporated; Salomon Brothers Inc; and Smith Barney Inc. (hereinafter referred to as the "Firms").

foreign broker or dealer affiliated with any of the Firms (a "U.S.-Affiliated Foreign Dealer") in the event that a U.S.-Affiliated Foreign Dealer engages in the securities activities described in Parts II.A through II.C of this letter without registering as a "broker" or "dealer" under Section 15 of the Securities Exchange Act of 1934, as amended (the "Exchange Act").

I. Background

In light of the growing internationalization of financial markets, the Commission provided securities firms in the late 1980's with significant guidance -- first through a series of no-action letters[2] and then through the adoption of Rule 15a-6 -- regarding the circumstances in which a foreign broker-dealer may engage in securities activities with U.S. persons without having to register under Section 15 of the Exchange Act.[3] In the years since adoption of Rule 15a-6, the internationalization of the securities markets has continued to accelerate. U.S. and foreign securities firms increasingly compete directly with one another to offer a comprehensive and cost-effective range of financial products and related services to their customers. At the same time, institutional investors have broadly come to consider it essential to take a global approach in formulating their investment strategy. In addition, the widespread availability of computer-based and related communication technologies has led to greater dissemination of securities-related information and trading activity across borders, and has heightened the interrelationship between U.S. and foreign markets.

Several aspects of the current U.S. regulatory regime unnecessarily restrict and hamper the global competitiveness of U.S. broker-dealers by severely limiting their ability to provide U.S. investors with access to securities products and local market expertise offered by foreign broker-dealers. In particular, Rule 15a-6 imposes a number of restrictions on both (i) the categories of institutional investors with which foreign broker-dealers may have contacts and (ii) the specific regulatory and procedural functions that must be performed by a U.S.

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2 See, e.g., National Westminster Bank PLC (July 7, 1988); Security Pacific Corporation (April 1, 1988); Chase Capital Markets U.S. (July 28, 1987).

3 Comparable issues arise in connection with the registration requirements for foreign government securities brokers or dealers under the Government Securities Act of 1986, codified at Section 15C of the Exchange Act. In this regard, the Department of the Treasury, pursuant to its authority under Section 15C(a)(5), has adopted an exemptive rule that largely parallels Rule 15a-6. See 17 C.F.R. § 401.9. Accordingly, pursuant to 17 C.F.R. § 400.2(d), the Firms request that any no-action or interpretive relief granted by the staff in response to this request with respect to the application of Section 15(a) of the Exchange Act and Rule 15a-6 also apply equally with respect to the entities that are subject to 17 C.F.R. § 401.9.

broker-dealer intermediating transactions between foreign broker-dealers and U.S. institutional investors. These restrictions have, in light of experience with the Rule and the evolution of the financial markets, proven unduly burdensome in many respects -- frequently in circumstances where they do not appear to achieve any clear offsetting regulatory benefits.

Accordingly, as a policy matter, the Firms strongly encourage the Commission to evaluate broad reforms to the U.S. regulatory regime that would enhance the competitiveness of U.S. securities firms and eliminate practical barriers to participation by their foreign affiliates in U.S. markets, while maintaining high standards of investor protection and market integrity in the United States and abroad. Moreover, a number of specific aspects of Rule 15a-6 pose significant obstacles to the effective conduct of international securities activities by U.S. broker-dealers and their foreign affiliates. In the Firms' view, the elimination of these obstacles requires especially prompt attention from the Commission that should not wait for the adoption of needed broader reforms. The Firms have therefore sought to identify, in Parts II.A through II.C below, those areas in which prompt interpretive or no-action relief from the staff would provide substantial benefits without compromising investor protection.

II. Proposed Relief

A. Expanded Definition of "Major U.S. Institutional Investor" in Rule 15a-6

Currently, the definitions of "major U.S. institutional investor" and "U.S. institutional investor" set forth in paragraphs (b)(4) and (b)(7) of Rule 15a-6, respectively, exclude a number of important categories of large and experienced institutional investors, thereby preventing foreign broker-dealers from effecting transactions with such investors in reliance on the exemption provided by paragraph (a)(3) of the Rule. Because direct contacts by a foreign broker-dealer with U.S. investors are permitted only if the investors meet these definitional criteria, the limitations under the current rule on eligible counterparties severely constrain the utility of that exemption.

At present, even the largest U.S. business corporations and partnerships do not qualify under the definitions of "U.S. institutional investor" and "major U.S. institutional investor." These business enterprises have a strong interest in obtaining direct access to foreign broker-dealers and form an important component of the investor base for which U.S. broker-dealers and their affiliates compete internationally. Moreover, these investors have the financial wherewithal and experience necessary to evaluate the potential rewards and risks of entering into transactions involving foreign broker-dealers.

In addition, a number of the most important institutional participants in the world financial markets are organized as investment funds advised by investment managers

exempt from registration under the Investment Advisers Act of 1940 (the "Investment Advisers Act") (typically because of the small number of clients that they advise). Because paragraph (b)(4) of Rule 15a-6 is never available for an unregistered adviser, the funds and other clients advised by these managers currently cannot qualify as "major U.S. institutional investors," despite their extensive experience in international markets and their substantial assets.

Accordingly, the Firms request that the Commission provide no-action relief that would expand the range of U.S. investors with which U.S.-Affiliated Foreign Dealers may enter into securities transactions in reliance on paragraph (a)(3) of Rule 15a-6. Specifically, the Firms request that the staff grant no-action relief that would permit, on the same basis as permitted for transactions with "major U.S. institutional investors" under Rule 15a-6, a U.S.-Affiliated Foreign Dealer to enter into transactions with 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 (i.e., cash, money-market instruments, securities of unaffiliated issuers, futures, options on futures and other derivative instruments).[4]

The requested relief would substantially enhance the utility of the paragraph (a)(3) exemption by extending its availability to transactions with important additional categories of investors whose experience and capabilities as to investment matters are comparable to those of "major U.S. institutional investors" that currently qualify under the Rule. In the Firms' view, no policy objective appears to be served by continuing to exclude such investors from the range of counterparties with which a U.S.-Affiliated Foreign Dealer may engage in transactions under the paragraph (a)(3) exemption, especially in light of the participation of a U.S. broker-dealer intermediary and the other protections afforded in transactions effected in reliance on that exemption.

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4 We understand that the asset test would be calculated on a gross basis, without deduction for liabilities of the institution, based on the balance sheet or comparable financial statement of the institution prepared in the ordinary course of its business. We also understand that the requested relief would apply to transactions in U.S. and foreign securities.

B. Direct Transfer of Funds and Securities Between U.S. Investors and U.S.-Affiliated Foreign Dealers

Rule 15a-6(a)(3) explicitly requires that a U.S. registered broker-dealer intermediating transactions between U.S. investors and a foreign broker-dealer assume responsibility for certain regulatory requirements. Specifically, paragraph (a)(3)(iii)(A)(6) of Rule 15a-6 requires that a U.S. broker-dealer intermediary be responsible for "receiving, delivering, and safeguarding funds and securities in connection with the transactions on behalf of the U.S. institutional investor or the major U.S. institutional investor in compliance with Rule 15c3-3" under the Exchange Act.

The application of paragraph (a)(3)(iii)(A)(6) is not entirely clear in circumstances where a U.S. investor and a foreign broker-dealer wish to settle a securities transaction intermediated by a U.S. broker-dealer involving the direct transfer of funds and securities. In particular, questions have arisen regarding whether, under the Rule, the clearance and settlement of all such transfers must be effected through the accounts of the U.S. broker-dealer intermediating the transaction.

In the Firms' view, a U.S. broker-dealer should not be required to interpose itself in the mechanical process of settling securities transactions effected pursuant to paragraph (a)(3). Interposition of a U.S. broker-dealer in the clearance and settlement process causes a significant duplication of functions by the U.S. and foreign broker-dealer (e.g., maintaining duplicate custody arrangements and bank accounts, and effecting duplicate transfers of funds and securities). This duplication of functions not only is inefficient from a cost perspective, but also increases the risk of operational errors and settlement failure (since twice the number of bookkeeping entries and transfers must occur). Moreover, entities qualifying as "U.S. institutional investors" and "major U.S. institutional investors" frequently elect (and may, in some cases, be required by law) to engage foreign custodians directly to hold, receive and deliver their foreign securities and local currency (including in circumstances where a foreign jurisdiction prohibits U.S. broker-dealers from holding securities or currency for customers). In this context, the current rule appears to provide little benefit to U.S. institutional investors and imposes a significant barrier to efficient settlement of international transactions.

Thus, the Firms request that the staff provide guidance confirming that, in transactions involving foreign securities[5] or U.S. Government securities intermediated by a

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5 For purposes of this request, we use the term "foreign securities" as defined in our previous correspondence relating to Rule 15a-6. See Cleary, Gottlieb, Steen & Hamilton (November 22, 1995, revised January 30, 1996).

U.S. broker-dealer under Rule 15a-6, clearance and settlement may occur through the direct transfer of funds and securities between the U.S. investor and the foreign broker-dealer in situations where the foreign broker-dealer is not acting as custodian of the funds or securities of the U.S. investor.[6] This guidance would confirm that for such transactions in such situations the U.S. investor or its custodian could transfer funds or such securities directly to the foreign broker-dealer or its agent and the foreign broker-dealer or its agent could transfer any funds or such securities directly to the U.S. investor or its custodian. We understand that this guidance would be applicable only in circumstances where (i) the foreign broker-dealer agrees to make available to the intermediating U.S. broker-dealer clearance and settlement information relating to such transfers and (ii) the foreign broker-dealer is not in default on any material financial market transactions.

This interpretive relief would enhance the ability of U.S. investors to enter into securities transactions with foreign broker-dealers without detracting significantly from the Commission's investor protection mandate under the Exchange Act. Although certain mechanical aspects of clearing and settling transactions would not be performed by the U.S. broker-dealer intermediary, U.S. investors would continue to benefit from the other protections provided by Rule 15a-6. In particular, the U.S. broker-dealer would fulfill all of the other enumerated duties under paragraph (a)(3)(iii)(A), including effecting the transactions, issuing required confirmations and maintaining required books and records relating to the transactions.[7]

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[6] In general, the difficulties described above relate primarily to transactions in foreign securities and U.S. Government securities and thus the Firms do not, at present, request that the staff address the issues that would be posed more generally by transactions involving U.S. securities, although it may be appropriate to do so in the context of anticipated rulemaking in this area.

[7] The inability of a foreign broker-dealer to receive and safeguard securities for customers in transactions effected under Rule 15a-6 presents a hindrance to the effective provision of cross-border securities services to U.S. investors. The laws of several foreign jurisdictions effectively prohibit a U.S. broker-dealer from clearing and settling transactions for its customers in those jurisdictions. In light of the obstacles that local legal, tax and similar restrictions may pose to the ability of a U.S. broker-dealer to provide safekeeping services to U.S. customers investing in a foreign country, we understand that the Commission staff has been and would continue to be willing to provide individual firms with prompt assistance addressing these concerns on a case-by-case basis through the no-action process. <u>See</u> Morgan Stanley India Securities Pvt. Ld. (December 20, 1996).

The requested relief would apply solely to the operational issue of the transfer of funds and securities between a foreign broker-dealer and a U.S. institutional investor or a major U.S. institutional investor (including an entity qualifying pursuant to the relief requested in Part II.A of this letter) in the context of clearance and settlement of transactions in foreign securities or U.S. Government securities between that foreign broker-dealer and that U.S. investor where the foreign broker-dealer is not acting as custodian for the U.S. investor. We understand that the granting of such relief should not be construed to suggest that the staff has made any implicit or explicit determination regarding the permissibility of any particular transaction or custodial arrangement related to such a transfer. In other words, the foreign broker-dealer would continue to be required to ensure that each such transaction and any custodial arrangement qualifies in all other respects for exemption under the Rule, even though the direct transfer of funds and securities would be permitted to occur as described above.

C. Permissible Contacts with U.S. Investors by Foreign Associated Persons of U.S.-Affiliated Foreign Dealers

Paragraph (a)(3) of Rule 15a-6 requires that an associated person of a U.S. broker-dealer intermediary participate in certain communications between foreign associated persons of a foreign broker-dealer and U.S. investors. Specifically, paragraph (a)(3)(iii)(B) requires that an associated person of the U.S. broker-dealer intermediary participate in any oral communications between foreign associated persons and U.S. institutional investors that are not "major U.S. institutional investors," and paragraph (a)(3)(ii)(A)(1) requires participation by an associated person of the U.S. broker-dealer intermediary in connection with visits in the United States by a foreign associated person with both U.S. institutional investors and major U.S. institutional investors.

1. Chaperoning Requirements

The "chaperoning" requirements prescribed by paragraph (a)(3) of Rule 15a-6 have proven awkward to implement in practice, particularly in the context of Asian markets separated from the United States by a large number of time zones. Moreover, "chaperoning" provides only slight policy benefits given the experience and capabilities of the U.S. institutional investors eligible to enter into transactions under paragraph (a)(3) and the other investor protections provided under that exemption, including in particular the requirement that any foreign associated person not be subject to a "statutory disqualification" as defined in Section 3(a)(39) of the Exchange Act. In addition, the apparent absence of significant abuses in the context of major U.S. institutional investors (for whom "chaperoning" of oral communications generally is not required) since the adoption of Rule 15a-6 further confirms the appropriateness of limiting the scope of the chaperoning requirement for all U.S. institutional investors eligible to have direct contacts with foreign broker-dealers under the Rule.

Accordingly, the Firms request that the staff grant no-action relief that would permit foreign associated persons of a U.S.-Affiliated Foreign Dealer, without the participation of an associated person of an affiliated Firm,[8] to (i) engage in oral communications from outside the United States with U.S. institutional investors where such communications take place outside of the trading hours of the New York Stock Exchange (i.e., at present, 9:30 a.m. to 4:00 p.m. New York Time), so long as the foreign associated persons do not accept orders to effect transactions other than those involving foreign securities (as defined in note 5 above) and, (ii) have in-person contacts during visits to the United States with major U.S. institutional investors (including those investors with which a U.S.-Affiliated Foreign Dealer would be able to enter into transactions pursuant to the relief requested in Part II.A of this 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 while in the United States to effect securities transactions.[9]

2. Electronic Quotation Systems

In the adopting release for Rule 15a-6,[10] the Commission directed a number of comments to the application of the broker-dealer registration requirement to foreign broker-dealers whose quotations are distributed to investors through electronic systems. Specifically, the Adopting Release sets forth the interpretive position that Rule 15a-6 "generally would permit the U.S. distribution of foreign broker-dealers' quotations by third party systems . . . that distributed these quotations primarily in foreign countries," but indicated that this position

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8 We understand that foreign associated persons of the U.S.-Affiliated Foreign Dealers would continue to be able to have "unchaperoned" contacts with U.S. persons at any time if they are "two-hatted" (i.e., also qualified as registered representatives acting on behalf of and under the supervision of an affiliated Firm under U.S. self-regulatory organization guidelines).

9 In addition to the specific relief relating to "chaperoned" contacts described above, the Firms request clarification from the staff 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 (including those entities qualifying pursuant to the relief requested in Part II.A of this letter) 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.

10 Release No. 27017 (July 11, 1989), 54 Fed. Reg. 30,013 (July 18, 1989) (the "Adopting Release").

would be available "only to third-party systems that did not allow securities transactions to be executed between the foreign broker-dealer and persons in the U.S. through the systems."[11] In the Firms' view, because third-party quotation services have become increasingly global in scope since the time of the adoption of Rule 15a-6, this distinction between systems that distribute quotations primarily in the U.S. and systems that distribute quotations "primarily in foreign countries" can no longer, in practice, serve as a useful dividing line for achieving the Commission's regulatory objectives.

With respect to proprietary quotation systems, the Adopting Release noted that "direct dissemination of a foreign market maker's quotations to U.S. investors, such as through a private quote system controlled by a foreign broker-dealer" would not be appropriate because the dissemination of such quotations would constitute a direct inducement to trade with that foreign broker-dealer.[12] There is no express indication, however, that the Commission's position in the Adopting Release is intended to preclude a foreign broker-dealer from directly "inducing" U.S. investors to trade with the foreign broker-dealer via a quotation system where the U.S. investor subscribes to the quotation system through a U.S. broker-dealer, the U.S. broker-dealer has continuing access to the quotation system, and the foreign broker-dealer's other contacts with U.S. investors are permissible under Rule 15a-6.

Where a U.S. institutional investor effects transactions through a U.S. broker-dealer intermediary, no customer protection or other policy objective would seem to be served by denying the institutional investor direct electronic access to the quotations of a foreign broker-dealer -- especially since Rule 15a-6 currently provides clear authority for the quotations to be conveyed orally (if inconveniently) through a registered representative associated with the U.S. broker-dealer. In the Firms' view, the availability of improved technologies for providing investors with quotations should not be restricted merely because it is impossible to "chaperone" a data transmission.

Accordingly, the Firms request the staff's advice clarifying that, in light of this technological evolution, the interpretive portions of the Adopting Release requiring operation of quotation systems by third parties that primarily distribute quotations in foreign countries no

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11 The Commission stated, however, that foreign broker-dealers whose quotes were distributed through such systems would not be allowed to initiate contacts with U.S. persons "beyond those exempted under [Rule 15a-6], without registration or further exemptive rulemaking." Adopting Release, 54 Fed. Reg. at 30,018.

12 Adopting Release, 54 Fed. Reg. at 30,019.

longer apply.[13] In this connection, the Firms specifically request confirmation by the staff that providing U.S. investors with access to proprietary and third-party screen-based quotation systems that supply quotations, prices and other trade-reporting information input directly by foreign broker-dealers will not constitute an impermissible "contact" with a foreign broker-dealer, so long as any transactions between the U.S. investor and the foreign broker-dealer are intermediated in accordance with the requirements of Rule 15a-6.[14] In addition, we understand that the staff would be willing to provide individual firms with prompt additional guidance regarding the execution of such intermediated transactions through an automated trading system operated by the registered U.S. broker-dealer intermediary.

III. Conclusion

Based on the foregoing, we request your advice that the staff would not recommend that the Commission take any enforcement action against any of the Firms or any U.S.-Affiliated Foreign Dealer in the event that a U.S.-Affiliated Foreign Dealer engages in the securities activities described in Parts II.A through II.C above without registering as a "broker" or "dealer" under Section 15 of the Exchange Act.

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[13] In addition to providing the specific clarification requested herein with regard to screen-based information systems, the Firms additionally encourage the Commission to continue its more general evaluation of issues under the Exchange Act and other federal securities laws relating to the impact of emerging technologies on the U.S. regulatory regime, including issues relating to electronic trading systems.

[14] We recognize in this connection, however, that a foreign broker-dealer that directs quotations to U.S. investors through a proprietary system (as distinct from a third-party system) would be viewed as having "solicited" any resulting transactions (and thus could not rely on the exemption in paragraph (a)(1) of Rule 15a-6), although it would continue to be allowed to effect transactions in reliance on other available provisions of the Rule.

We would appreciate consideration of these matters as promptly as practicable. If for any reason the staff is not disposed to grant the requested no-action relief, we would also appreciate an opportunity to discuss the situation with the staff prior to the issuance of any formal letters. Questions regarding this no-action request should be directed to the undersigned (at 202-728-2758).

Sincerely yours,

Giovanni P. Prezioso

cc: Mr. Robert L.D. Colby
Deputy Director
Division of Market Regulation

Ms. Catherine McGuire
Chief Counsel
Division of Market Regulation

DIVISION OF
MARKET REGULATION

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

January 30, 1996

Giovanni P. Prezioso, Esq.
Cleary, Gottlieb, Steen & Hamilton
1752 N Street, N.W.
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Public Reference Copy

Re: Transactions in Foreign Securities by Foreign Brokers or Dealers with Accounts of Certain Foreign Persons Managed or Advised by U.S. Resident Fiduciaries

Dear Mr. Prezioso:

In your letter of November 13, 1995 on behalf of seven registered broker-dealers (the "Firms")1/, as supplemented by conversations with the staff, you request assurances that the staff will not recommend enforcement action to the Commission under Section 15(a) of the Securities Exchange Act of 1934 ("Exchange Act"), if any of the Firms or a foreign broker or dealer affiliated with any of the Firms ("U.S. Affiliated Foreign Broker-Dealer") engages in the activities described below without the U.S. Affiliated Foreign Broker-Dealer registering as a broker-dealer in accordance with the provisions of Section 15(b) of the Exchange Act. This staff position supersedes and replaces our letter to you dated November 22, 1995.

We understand the facts to be as follows:

When a foreign broker-dealer engages in securities transactions with a U.S. person, the foreign broker-dealer generally must register with the Commission as a broker-dealer pursuant to Section 15 of the Exchange Act, unless an exemption applies. Rule 15a-6 under the Exchange Act provides a number of exemptions to this general rule for foreign broker-dealers engaged in certain activities involving U.S. institutional investors.2/ For example, Rule 15a-6(a)(3) exempts transactions arranged by a foreign broker-dealer with a U.S. institutional investor or a major U.S. institutional investor, as those terms are defined in the

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1/ The Firms include Bear Stearns & Co., Inc.; CS First Boston Corporation; CSFP Capital, Inc.; Goldman, Sachs & Co.; Lehman Brothers, Inc.; Morgan Stanley & Co., Incorporated; and Salomon Brothers Inc.

2/ See generally Securities Exchange Act Release No. 27017 (July 11, 1989), 54 FR 30013.

rule, as long as the U.S.-registered broker-dealer "handle[s] all aspects of these transactions except negotiation of their terms."3/

For purposes of both the broker-dealer registration provisions of the Exchange Act and Rule 15a-6, persons resident in the United States are among the persons deemed to be U.S. persons. A U.S. resident fiduciary, therefore, is considered to be a U.S. person for these purposes, regardless of the residence of the owners of the underlying accounts. Thus, when a foreign broker-dealer -- such as a U.S. Affiliated Foreign Broker-Dealer -- solicits discretionary or similar accounts of non-U.S. persons held by a U.S. resident fiduciary (including a U.S. registered investment adviser), it must either register with the Commission, or effect such transactions in accordance with Rule 15a-6(a)(3).4/ In other words, a U.S. Affiliated Foreign Broker-Dealer generally may effect transactions in Foreign Securities (as defined below) for a non-U.S. client without becoming subject to the broker-dealer registration provisions of the federal securities laws. This is not the case, however, when the non-U.S. client is represented by a U.S. resident fiduciary.

In your view, the beneficial owners of these accounts would not reasonably expect the U.S. broker-dealer regulatory requirements to apply to their transactions in Foreign Securities with the U.S. Affiliated Foreign Broker-Dealers merely because their accounts are managed by U.S. resident fiduciaries. While, currently, the U.S. Affiliated Foreign Broker-Dealers effect such transactions in compliance with the requirements of Rule 15a-6(a)(3), you believe that such compliance is burdensome and unnecessary in this narrow context. Moreover, you state that the application of the U.S. broker-dealer regulatory scheme to such transactions places the U.S. Affiliated Foreign Broker-Dealers at a competitive disadvantage with other foreign broker-dealers.

You, therefore, have requested assurances from the staff that it would not recommend enforcement action to the Commission if the U.S. Affiliated Foreign Broker-Dealers effect transactions in "Foreign Securities" for "Offshore Clients" using "U.S. Resident Fiduciaries," as these terms are defined below. As described in your letter, a U.S. Resident Fiduciary is not a registered broker-dealer or a bank acting in a broker-dealer capacity within the meaning of Exchange Act Rule 15a-6(a)(4)(i). A U.S. Resident Fiduciary may or may not be affiliated with U.S. or foreign broker-dealers, and may or may not be registered under the Investment Advisers Act of 1940.

In addition, you define an Offshore Client as: (1) 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 U.S. federal income tax purposes; (2) any natural person who is not a

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3/ Id., 54 FR at 30029.

4/ See Letter re: Regulation S Transactions during Distributions of Foreign Securities to Qualified Institutional Buyers (February 22, 1994). This position does not apply to a U.S. registered broker or dealer or a bank acting in a broker or dealer capacity as permitted by U.S. law. See Rule 15a-6(a)(4).

U.S. resident;5/ or (3) any entity not organized or incorporated under the laws of the United States substantially all of the outstanding voting securities of which are beneficially owned by the persons described in (1) and (2), above.

Finally, you define a "Foreign Security" as: (1) 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 or through Nasdaq system;6/ or (2) 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.7/ For purposes of this definition, the status of over-the-counter ("OTC") derivative instruments would be determined by reference to the underlying instrument.8/

Response:

While not necessarily agreeing with the reasoning contained in your letter, based on the facts presented and the representations you have made, and particularly on the representations that (1) the U.S. Affiliated Foreign Broker-Dealer will obtain written assurance from the U.S. Resident Fiduciary that the account is managed for an Offshore

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5/ For purposes of this letter, a U.S. citizen residing in a foreign country would continue to be viewed as a resident of the United States unless the citizen (1) has $500,000 or more under the management of the U.S. Resident Fiduciary with whom a U.S. Affiliated Foreign Broker-Dealer transacts business, or (2) has, together with his or her spouse, a net worth in excess of $1,000,000.

6/ For purposes of this definition, a depository receipt issued by a U.S. bank would not be considered a Foreign Security unless it is initially offered and sold outside the United States in accordance with Regulation S under the Securities Act of 1933 ("Securities Act"). None of the definitions used for purposes of this letter should be construed as affecting the interpretation of terms used in Regulation S.

7/ For purposes of this definition, securities issued in a distribution outside the United States include securities offered and sold in accordance with Regulation S under the Securities Act. Debt securities of an issuer organized or incorporated under the laws of the United States would not be considered Foreign Securities if they were 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. Securities that are offered and sold outside the United States in accordance with Regulation S, however, would not lose their status as Foreign Securities as a result of offers and sales of securities of that issue to investors in the United States by means of either private placements pursuant to Section 4(2) of the Securities Act, or transactions effected pursuant to Securities Act Rule 144A or other resale transactions exempt from Securities Act registration.

8/ For example, an OTC derivative on a Foreign Security would be a Foreign Security, even if the writer of the instrument was a U.S. person. Similarly, an OTC derivative on a security other than a Foreign Security would not be a Foreign Security.

Client, (2) transactions with U.S. Resident Fiduciaries for Offshore Clients, other than transactions in Foreign Securities, will be effected in compliance with the requirements of either Section 15(a) of the Exchange Act or Rule 15a-6 thereunder, and (3) transactions effected with U.S. Resident Fiduciaries, other than transactions for Offshore Clients, will be effected in compliance with the requirements of either Section 15(a) of the Exchange Act or Rule 15a-6 thereunder, the staff would not recommend enforcement action to the Commission if U.S. Affiliated Foreign Broker-Dealers effect transactions in Foreign Securities with U.S. Resident Fiduciaries for Offshore Clients without the U.S. Affiliated Foreign Broker-Dealers either registering as broker-dealers or effecting the transactions in accordance with Rule 15a-6 under the Exchange Act.

This position concerns enforcement action only and does not represent a legal conclusion regarding the applicability of statutory or regulatory provisions of the federal securities laws. Moreover, this position is based on strict adherence by the U.S. Affiliated Foreign Broker-Dealers to the representations in this letter, and any different facts or conditions might require a different response.

Sincerely,

Catherine McGuire
Chief Counsel

CM:PJ/cn

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*NOT ADMITTED IN THE DISTRICT OF COLUMBIA

Securities Exchange Act of 1934
Section 15(a); Rule 15a-6

November 13, 1995

Ms. Catherine McGuire
Chief Counsel
Division of Market Regulation
Securities and Exchange Commission
450 5th Street, N.W.
Washington, D.C. 20549

Re: Transactions in Foreign Securities by Foreign Brokers or Dealers with Accounts of Foreign Persons Managed or Advised by U.S. Resident Fiduciaries

Dear Ms. McGuire:

We are writing on behalf of our clients, listed in note 1 hereof,[1] to request your advice that the staff would not recommend that the Securities and Exchange Commission (the "Commission") take any enforcement action against any of the Firms or any foreign broker or dealer affiliated with any of the Firms (a "U.S.-Affiliated Foreign Dealer") in the event that the U.S.-Affiliated Foreign Dealer does not register as a "broker" or "dealer" under Section 15 of the Securities Exchange Act of 1934,

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1/ Bear, Stearns & Co. Inc.; CS First Boston Corporation; CSFP Capital, Inc.; Goldman, Sachs & Co.; Lehman Brothers Inc.; Morgan Stanley & Co. Incorporated; and Salomon Brothers Inc (hereinafter referred to as the "Firms").

as amended (the "Exchange Act"), by virtue of its entering into purchases and sales of, and borrowing and lending and other transactions in, foreign securities ("foreign securities transactions") with or for a discretionary or similar account of an Offshore Client (as defined below) managed by a U.S. resident professional fiduciary ("U.S. resident fiduciary") without the involvement of a U.S. registered broker-dealer pursuant to Rule 15a-6 under the Exchange Act.

The term "Offshore Client" is used in this letter to refer to (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;[2] or (iii) any entity not organized or incorporated under the laws of the United States substantially all of whose outstanding voting securities (e.g., 85 percent or more) are beneficially owned by persons in categories (i) and (ii) above.[3]

Except where otherwise indicated, the term "foreign security" is used in this letter to refer to:

(i) a security issued by an issuer not organized or incorporated under the laws of the United States, provided the transaction which involves such security is not effected on a U.S. exchange or Nasdaq;[4] and

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[2] For these purposes, a U.S. citizen residing in a foreign country would continue to be viewed as a resident of the United States unless the citizen (i) has $500,000 or more under the management of the U.S. resident fiduciary with whom a U.S. Affiliated Foreign Broker-Dealer transacts business or (ii) has a net worth (together with the citizen's spouse) in excess of $1,000,000.

[3] Prior to entering into the initial transaction with the account of an Offshore Client managed by a U.S. resident fiduciary (other than in reliance on Rule 15a-6(a)(3) or other exemptive relief), a foreign broker-dealer would obtain a representation by the U.S. resident fiduciary that the account under its management is an Offshore Client as defined above.

[4] For purposes of this definition, a depositary receipt issued by a U.S. bank would not be viewed as a foreign security unless the depositary receipt is initially offered and sold (continued...)

(ii) a debt security (including a convertible debt security) issued by an issuer organized or incorporated under the laws of the United States in connection with a distribution conducted outside the United States.[5]

For purposes of this definition, the status of over-the-counter derivatives that are securities ("OTC derivatives") would be determined by reference to the underlying instrument. For example, an OTC derivative on a foreign security would be a foreign security even if the writer of the instrument were a U.S. person. Similarly, an OTC derivative on a security other than a foreign security would not be a foreign security.

The term "foreign broker or dealer" has the same meaning herein as in Rule 15a-6(b)(3) and is used interchangeably herein with the term "foreign broker-dealer" unless the context otherwise requires. For purposes of this no-action request, it is assumed that the U.S. resident fiduciary (i) is not a registered broker-dealer or a bank acting in a broker-dealer capacity within the meaning of Rule 15a-6(a)(4)(i) under the Exchange Act, (ii) may or may not be affiliated with U.S. or foreign broker-dealers and (iii) may or may not be registered

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[4] (...continued) outside the United States in accordance with Regulation S under the Securities Act of 1933 (the "Securities Act").

[5] For these purposes, we understand that securities issued in a distribution conducted outside the United States would include securities offered and sold in accordance with Securities Act Regulation S. Debt securities of an issuer organized or incorporated under the laws of the United States would not qualify as "foreign securities" if 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. We understand, however, that securities offered and sold outside the United States in accordance with Regulation S would not lose their status as "foreign securities" as a result of offers and sales of securities of that issue to investors in the United States in a private placement pursuant to Section 4(2) of the Securities Act or in transactions effected pursuant Securities Act Rule 144A or in other resale transactions exempt from Securities Act registration.

under the Investment Advisers Act of 1940, as amended (the "Advisers Act").[6]

Background

A. Foreign Securities Transactions

Increasing amounts of investment capital are being placed in investment vehicles established as Offshore Clients. These Offshore Clients consist primarily of institutional investors, including foreign corporate investors, pension funds and investment funds and other foreign investment vehicles. Certain of the Offshore Clients may have U.S. persons among their investors. Offshore Clients have shown a growing desire to use U.S. resident fiduciaries to manage portions of their securities portfolios and to use foreign broker-dealer affiliates of U.S. registered broker-dealers for their foreign securities transactions, as long as the use of these services does not result in an unjustifiable U.S. regulatory burden.

The efficient conduct of foreign securities transactions has been impaired, however, by concerns relating to whether an unregistered foreign broker-dealer may enter into foreign securities transactions with Offshore Clients using U.S. resident fiduciaries without the involvement of a U.S. registered broker-dealer in compliance with Rule 15a-6.

These concerns have generated a significant competitive disadvantage for U.S. registered broker-dealers, U.S.-Affiliated Foreign Dealers and U.S. resident fiduciaries. The competitive disadvantage is particularly acute with respect to foreign securities transactions where a U.S. broker-dealer cannot arrange credit extended by a U.S.-Affiliated Foreign Dealer on terms more favorable than the terms upon which the U.S. broker-dealer could extend the credit (i.e., in cases where no Regulation T arranging exception is available). Currently, the arranging exception provided by Section 220.13(d) of Regulation T permits a U.S. broker-dealer to arrange credit extended by a foreign person only to purchase a "foreign security," as that term is defined in Regulation T (i.e., "a security issued in a jurisdiction other than the United States"). Thus, the exception is not available

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[6] Many U.S. resident fiduciaries operate offices only in the United States, or carry out certain investment management activities only in U.S. offices, for various financial, operational and legal reasons. Some U.S. resident fiduciaries may maintain foreign offices.

with respect to securities borrowing and lending transactions and short sales of such securities. Moreover, the exception does not apply even to purchase transactions involving securities other than "foreign securities" as defined in the Regulation.

Furthermore, even if the arranging exemption provided by Section 220.13(d) of Regulation T is available, the involvement of Rule 15a-6 intermediation for foreign securities transactions results in the additional significant competitive disadvantage of precluding the consolidated reporting of all of an Offshore Client's foreign securities transactions and the provision of other global services in respect of such transactions at a U.S.-Affiliated Foreign Dealer.

The Firms believe that the granting of the no-action relief requested in this letter would help mitigate the current competitive disadvantage of U.S. registered broker-dealers, U.S.-Affiliated Foreign Dealers and U.S. resident fiduciaries, and would facilitate the ability of Offshore Clients to make use of various securities services including execution, custody, recordkeeping and financing ("global securities services") provided by U.S.-Affiliated Foreign Dealers.

In the absence of the no-action relief requested in this letter, or any other available relief under Rule 15a-6 or otherwise, an unregistered foreign broker-dealer wishing to rely on Rule 15a-6 in entering into foreign securities transactions with Offshore Clients using U.S. resident fiduciaries would be required, among other things, to enter into these transactions through a registered broker-dealer intermediary. The intermediation of the registered broker-dealer would impose upon the Offshore Client the requirement that the foreign securities transactions be effected in accordance with a number of U.S. securities laws and regulations applicable to the registered broker-dealer and the foreign securities transactions. These U.S. securities regulations are often inconsistent with and may be more restrictive than the various local securities laws and regulations applicable to these transactions, burdening these transactions with incremental economic and operational costs. As a consequence, the Firms have found that Offshore Clients wishing to effect foreign securities transactions tend to prefer doing business with a foreign broker-dealer that considers itself outside the ambit of the Rule 15a-6 conditions rather than with a foreign broker-dealer that believes it is subject to these conditions.

B. U.S.-Affiliated Foreign Dealers

In the Firms' experience, U.S.-Affiliated Foreign Dealers who enter into foreign securities transactions with U.S. resident fiduciaries for Offshore Clients pursuant to Rule 15a-6 (and thereby involve a U.S. broker in effecting such transactions) are at a competitive disadvantage to foreign dealers which do not have U.S. affiliates and which appear to be more willing to take a position that they need not comply with the intermediation procedures of Rule 15a-6 in order to carry out foreign securities transactions with Offshore Clients whether or not the Offshore Clients have U.S. resident fiduciaries. As noted above, foreign broker-dealers, especially U.S.-Affiliated Foreign Dealers, who comply with the Rule 15a-6 requirements for the execution of transactions through a registered broker-dealer intermediary will subject the transactions to certain U.S. regulatory and operational restraints that foreign broker-dealers do not face in executing transactions that are not so intermediated. Foreign broker-dealers, including U.S.-Affiliated Foreign Dealers, are registered in their local jurisdictions and are already subject to comprehensive local securities laws and regulations.

Furthermore, as described in more detail below, some U.S.-Affiliated Foreign Dealers believe that they are at a disadvantage in competing with other foreign dealers for global securities services as a result of this U.S. regulatory uncertainty. The global securities services provided by U.S.-Affiliated Foreign Dealers help coordinate and consolidate an Offshore Client's foreign securities transactions just as domestic securities services provided by registered broker-dealers do for the Offshore Client's U.S. transactions.

C. U.S. Resident Fiduciaries

The Firms believe that U.S. resident fiduciaries are at a competitive disadvantage to non-U.S. resident fiduciaries because Offshore Clients are unwilling to subject their foreign securities transactions to U.S. broker-dealer regulation, in addition to applicable local securities regulation, solely by virtue of using a U.S. resident fiduciary. While an Offshore Client might reasonably expect the protection of the U.S. securities laws (e.g., the Advisers Act) to attach by virtue of its selection of a U.S. resident fiduciary, few Offshore Clients would reasonably expect that the broker-dealer regulatory scheme of the Exchange Act and related Securities Investor Protection Act insurance protection would also apply (and few would want application of this scheme if it burdened the Offshore Clients

with the incremental economic costs of compliance). U.S. resident fiduciaries, in order to remain competitive with foreign investment advisers, must be able to provide the capability to enter into foreign securities transactions for their Offshore Clients on terms and conditions that are comparable to what Offshore Clients may obtain from foreign investment advisers.

D. Global Securities Services

Offshore Clients now have considerable concern about their ability to use U.S.-Affiliated Foreign Dealers as providers of global securities services (e.g., prime brokerage services) to coordinate their foreign securities transactions. The advantages to Offshore Clients of having the option to select U.S.-Affiliated Foreign Dealers as their providers of global securities services include: (1) good global clearance, settlement and trade execution capabilities, including expertise in the emerging markets; (2) foreign securities borrowing and lending capabilities to support the trading, including short sales transactions, of these Offshore Clients; (3) financing capabilities, including margin financing; and (4) worldwide consolidated portfolio reporting.

As many Offshore Clients have satisfactory and successful domestic securities services relationships with U.S. broker-dealers, they very much would like to have the option to continue those relationships where U.S.-Affiliated Foreign Dealers could offer global securities services facilities with worldwide consolidated reporting. These Offshore Clients therefore would like the opportunity not only to have relationships with U.S.-Affiliated Foreign Dealers but also to maintain and expand their relationships with related U.S. broker-dealers.

At present, however, Offshore Clients find it less practical to use U.S.-Affiliated Foreign Dealers for any foreign securities transactions because of limitations on the ability of U.S. broker-dealers to arrange credit extended by U.S.-Affiliated Foreign Dealers. As indicated above, even though the Regulation T arranging exemption is available in some cases for an Offshore Client's purchase transactions, the need to involve a U.S. broker-dealer for intermediation of transactions under Rule 15a-6 now effectively precludes access by the Offshore Client to consolidated reporting and other global securities services at a U.S.-Affiliated Foreign Dealer in respect of all of its foreign securities transactions.

The Firms believe that the no-action relief requested in this letter would, therefore, doubly enhance competitive opportunities for U.S. registered broker-dealers, U.S.-Affiliated Foreign Dealers and U.S. resident fiduciaries in foreign transactions with Offshore Clients. First, the relief would permit U.S.-Affiliated Foreign Dealers to compete effectively for securities borrowing and lending and short sale transactions of Offshore Clients without the burden of Rule 15a-6 intermediation. Second, the relief would enable U.S.-Affiliated Foreign Dealers to provide, and enhance the ability of U.S. resident fiduciaries to utilize, global securities services for all of the Offshore Client's foreign securities transactions. The relief would recognize, in a practical way, the increasing desire of Offshore Clients to consolidate their foreign securities transactions activity and global securities services with broker-dealers outside the United States.

Analysis

A. Scope of Section 15(a)

Section 15(a) of the Exchange Act requires any "broker" or "dealer"[7] using U.S. jurisdictional means to effect securities transactions to register as a broker or dealer with the Commission. While Section 30(b) of the Exchange Act provides that the Exchange Act shall not apply to persons "transact[ing] a business in securities without the jurisdiction of the United States," the Commission has expressed the view that this exemption is unavailable if transactions occur in U.S. securities markets.[8]

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[7] The term "broker" is defined in Exchange Act Section 3(a)(4) as "any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank." A "dealer" is defined in Exchange Act Section 3(a)(5) as "any person engaged in the business of buying or selling securities for his own account, through a broker or otherwise, but does not include a bank, or any person insofar as he buys or sells securities for his own account, either individually or in some fiduciary capacity, but not as a part of a regular business."

[8] Release No. 34-27017, 54 Fed. Reg. at 30,016 n.41 (July 18, 1989).

In 1989, the Commission promulgated Rule 15a-6 to provide non-exclusive safe-harbor exemptions[9] from the Section 15 registration requirement for foreign broker-dealers desiring to engage in certain securities activities with U.S. investors.[10] Rule 15a-6 was adopted in recognition of the desire by investors located in the United States, especially institutional investors, to trade more actively in international financial markets.[11]

Rule 15a-(6)(a)(3) provides that foreign broker-dealers seeking to engage in securities activities with U.S. institutional and major U.S. institutional investors[12] are exempt from the registration requirements of Section 15 of the Exchange Act if they comply with various requirements including effecting the transactions through a registered broker-dealer.[13]

9/ The Commission stated expressly in the preamble to its adoption of Rule 15a-6 that prior no-action letters (and, implicitly, the interpretive principles contained therein) would remain generally in effect. Id. at 30,020.

10/ Id. at 30,013.

11/ Id. at 30,014.

12/ Investment advisers are not included in the definition of a U.S. institutional investor in Rule 15a-6. Under Rule 15a-6(b)(4)(ii), however, investment advisers registered under Section 203 of the Investment Advisers Act of 1940, with assets or assets under management in excess of $100 million, are included in the definition of major U.S. institutional investor for purposes of the Rule.

13/ Any transactions resulting from contacts between the foreign broker-dealer and the U.S. institutional and major U.S. institutional investors must be effected through the intermediary registered broker-dealer. Rule 15a-6(a)(3)(i)(A). Of considerable potential significance to many Offshore Clients, as indicated above, the intermediary registered broker-dealer (who is subject to U.S. margin regulation) has responsibility, as between it and the foreign broker-dealer, for extending or arranging any credit to the U.S. institutional or major U.S. institutional investor in connection with these transactions.

In adopting Rule 15a-6, the Commission noted that it now generally uses a territorial approach in applying broker-dealer registration requirements to the international operations of brokers and dealers.[14] The Rule 15a-6 exemptions in part incorporate certain exceptions to the Commission's territorial approach to broker-dealer registration requirements for transactions with certain categories of non-U.S. persons present in the United States. These exceptions cover, among other persons, a foreign person temporarily present in the United States, with whom the foreign broker-dealer had a bona fide, pre-existing relationship before the foreign person entered the United States and do not require U.S. broker-dealer intermediation.[15]

B. Application of Section 15(a) to Foreign Securities Transactions in Offshore Client Accounts with U.S. Resident Fiduciaries

From a Section 15(a) perspective, an Offshore Client whose account is managed by a U.S. resident fiduciary is in a position comparable to that of a foreign person temporarily present in the United States (with whom a foreign broker-dealer would be permitted to deal directly under Rule 15a-6(a)(4)(iii)). Offshore Clients who choose to have relationships with U.S. resident fiduciaries generally are active global traders and investors who have experience entering into foreign securities transactions around the world. This experience has led them to expect and understand that they must obey the laws and regulations of the jurisdictions where they trade or engage in securities transactions. These Offshore Clients have a clear comprehension of the existence of active local regulation that applies to their foreign securities transactions and to any foreign broker-dealers involved in such transactions, including U.S.-Affiliated Foreign Dealers. Consequently, Offshore Clients may expect Advisers Act regulation to govern any registered U.S. resident fiduciary that they have selected, but would not reasonably expect that the full range of U.S. laws and regulations governing broker-dealers should apply to their

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[14] Release No. 34-27017, 54 Fed. Reg. at 30,016 (July 18, 1989).

[15] See Rule 15a-6(a)(4)(iii). In providing this exception the Commission noted that "the primary responsibility for protecting foreign investors from wrongful conduct of foreign securities professionals properly lies with foreign securities regulators." Release No. 34-25801, 53 Fed. Reg. at 23,649 (June 23, 1988).

foreign securities transactions with foreign broker-dealers just because they have retained a U.S. investment adviser.

The relief requested in this letter would be consistent with the exception for foreign persons temporarily present in the United States. As in the case of a foreign person temporarily present in the United States, an Offshore Client would not reasonably expect, as noted above, that U.S. broker-dealer regulatory requirements would apply to foreign securities transactions entered into for its account with a foreign broker-dealer. Moreover, an Offshore Client whose account is managed by a U.S. resident fiduciary -- and who may have no physical presence in the United States -- would appear to present an even better case for exception under the territorial principles of Rule 15a-6 than a foreign person covered under Rule 15a-6(a)(4)(iii).

C. Consistency with Other Commission Policies

We believe that the relief requested in this letter would also help achieve greater consistency between broker-dealer registration policy under the Exchange Act and other Commission policies, such as those reflected in Regulation S under the Securities Act, that operate to avoid disadvantaging U.S. resident fiduciaries acting on behalf of Offshore Clients.

Regulation S, like Rule 15a-6, is based upon a territorial approach to jurisdiction, extending registration protection only to U.S. capital markets in light of principles of comity and the "reasonable expectations of participants in the global markets."[16] Generally, Regulation S exempts from registration securities sold in "offshore transactions," wherein an offer is not made to U.S. persons and the non-U.S. buyers of the security are located outside the United States.[17]

Regulation S specifically excepts U.S. professional fiduciaries acting with discretion for the accounts of non-U.S. persons from the definition of "U.S. Person," and excepts transactions with such persons from the class of transactions located in the United States by classifying them as offshore transactions.[18] The Commission adopted this exception explicitly "[i]n light of the serious competitive disadvantages

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[16] Release No. 33-6863, 55 Fed. Reg. at 18,308 (May 2, 1990).

[17] 17 C.F.R. § 230.902(i).

[18] 17 C.F.R. § 230.902(i)(3), (o)(2).

that might [otherwise] be faced by U.S. professional fiduciaries."[19/] The Regulation S exemption for offers and sales to U.S. professional fiduciaries acting on behalf of foreign investors is a codification of the position taken by the Staff in the Baer Securities no-action letter.[20/]

The exclusion of foreign broker-dealers engaging in foreign securities transactions with U.S. resident fiduciaries acting on behalf of Offshore Clients from broker-dealer registration requirements under the Exchange Act would serve the same competitive goals as does the exclusion from Securities Act registration requirements under Baer Securities and Regulation S. The treatment of U.S. advisers under Baer Securities and Regulation S allows them to compete more evenly with non-U.S. investment advisers, who are free to buy unregistered foreign securities on behalf of non-U.S. persons. Similarly, excluding foreign broker-dealers dealing with U.S. resident fiduciaries acting on behalf of Offshore Clients from the effects of U.S. margin, intermediation and other Rule 15a-6 requirements in foreign securities transactions will allow U.S. resident fiduciaries seeking to provide investment advisory services to Offshore Clients to compete more evenly with non-U.S. investment advisers, who do not subject foreign broker-dealers to U.S. regulation when dealing with them on behalf of their Offshore Clients.

Conclusion

For the foregoing reasons, we respectfully request that the staff take the position that it would not recommend that the Commission take any enforcement action against a Firm or a U.S.-Affiliated Foreign Dealer by virtue of its engaging in foreign securities transactions, in the circumstances described above, with or for the account of an Offshore Client acting through a U.S. resident fiduciary in the manner described without registering as a broker or dealer under Section 15 of the Exchange Act or complying with the various statutory and regulatory requirements imposed on a "broker" or "dealer" as defined in Sections 3(a)(4) and 3(a)(5) of the Exchange Act.

We would appreciate consideration of this matter as promptly as practicable. If for any reason the staff is not disposed to grant the requested no-action relief, we would also

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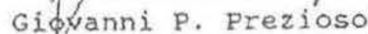
19/ Release No. 33-6863, 55 Fed. Reg. at 18,317 (May 2, 1990).

20/ Baer Securities Corporation (Oct. 12, 1979).

appreciate an opportunity to discuss the situation with the staff prior to the issuance of any formal letters. Questions regarding this no-action request should be directed to the undersigned (at 202-728-2758), J. Eugene Marans (at 202-728-2888) or Alan L. Beller (at 212-225-2450).

Very truly yours,



Giovanni P. Prezioso

cc: Mr. Robert L.D. Colby
Deputy Director
Division of Market Regulation

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