

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 10:00 am and 3:00 pm. 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 FUTHER 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,

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.

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 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

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.

⁸ See 1988 Proposing Release.

⁹ 17 CFR 240.15a-6. See 1989 Adopting Release.

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)

¹⁰ 17 CFR 240.15a-6(b)(3).

“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-6¹³ 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

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.

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-6²¹ provides an exemption from U.S. broker-dealer

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

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 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 investor²⁴ 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

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.

²⁴ See Part II.C., infra, for discussion of the definition of “U.S. institutional investor.”

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-6²⁷ 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

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.

confirmations²⁹ 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

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).

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

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).

D. Counterparties and Specific Customers

Paragraph (a)(4) of Rule 15a-6⁴⁰ 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 (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

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).

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-dealer⁴⁶ 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

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).

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:

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. No. 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. No. 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. No. 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),

- (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;

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.

- (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 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

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.

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

⁵² See 15 U.S.C 6801 *et seq.*, Pub. L. No. 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).

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

⁵³ See 1989 Adopting Release, 54 FR at 30027.

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 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.

⁵⁴ See 1989 Adopting Release, 54 FR at 30017.

⁵⁵ See id.

⁵⁶ See id. at 30021.

⁵⁷ See id. at 30017.

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

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).

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 quotation systems, or proprietary quotation systems, that the Commission should address? Is guidance needed under the Commission's interpretation of solicitation for other

⁶² Cf. 1997 Staff Letter.

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 ATS⁶³ 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

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.

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.

⁶⁷ See 1989 Adopting Release, 54 FR at 30021.

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.

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

⁶⁸ See proposed Rule 15a-6(a)(3)(iii)(A).

⁶⁹ See Part III.D.1.a.ii., *infra*, for discussion of “foreign business.”

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.”

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).

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

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.”).

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

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).

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-8⁸¹ with respect to customers of foreign broker-dealers relying on Exemption (A)(1). Rule 17a-8 requires a 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

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.

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.

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

⁸⁴ See Part II.B., supra.

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).

⁸⁵ See proposed Rule 15a-6(b)(2)(i).

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).

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).

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 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 clients⁹⁰ 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-à-vis U.S. securities markets because the foreign broker-dealer’s business in U.S. securities would be limited.

⁸⁹ See proposed Rule 15a-6(b)(2)(ii).

⁹⁰ See Part III.E., infra.

⁹¹ See proposed Rule 15a-6(b)(3).

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

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

- (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 $(100 \times \$10.00) + (100 \times \$10.00)$).

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

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).

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

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.

