PROSKAUER ROSE LLP®

Client Alert

A report for clients and friends of the Firm

July 2008

Critical Issues Affecting Non-U.S. Broker-Dealers Under the Proposed Amendments to Rule 15a-6

The SEC has proposed amendments to Rule 15a-6 under the Securities Exchange Act of 1934 which are intended to improve the access of U.S. investors to foreign markets. The rule provides an exemption from registration for foreign broker-dealers that conduct limited activities in the United States. Although the original rule, adopted in1989, was a great advance in furthering cross-border trading, it has long been viewed by industry participants as overly cumbersome and unnecessarily restrictive. Click here to view the proposal.

The proposed amendments would broaden the scope of the exemption and liberalize the manner in which foreign broker-dealers may deal with U.S. investors. Importantly, the amendments would generally expand the class of investors that foreign broker-dealers may solicit for the purpose of buying or selling securities (although the new category would also omit some important investors currently covered by the rule). Chaperoning requirements under the current rule would also be eliminated so that foreign broker-dealers could communicate directly with eligible investors without the participation of a registered broker-dealer. And, a foreign broker-dealer would be permitted to effect securities transactions that result from those communications. The activity would still require the intermediation of a registered broker-dealer to maintain related books and records and, depending on the nature of the foreign broker-dealer's business, to safeguard customer funds and securities.

The SEC has requested comments on the proposed amendments by **September 8, 2008**. The comment process presents a crucial opportunity to correct certain important omissions and to eliminate unnecessary obstacles and undue complexities in complying with the rule.

The Current Rule 15a-6 Exemption

Rule 15a-6 currently provides an exemption from registration for foreign broker-dealers that conduct limited business in the United States, including the following four categories of activities:

Unsolicited Transactions: This exemption permits a foreign broker-dealer to effect trades with U.S. persons on an unsolicited basis. (Note that the SEC defines "solicitation" broadly, to include any affirmative effort to induce transactional business, such as making phone calls, advertising, holding investment seminars or recommending the purchase or sale of securities.)

Research and Related Transactions: This exemption permits foreign broker-dealers to distribute research to major U.S. institutional investors and provided certain conditions are met, the foreign firm may effect trades in the securities discussed in the research either directly or through a U.S. registered broker-dealer with whom the foreign broker-dealer has established a relationship for that purpose.

Solicitation of Investors: This exemption permits foreign broker-dealers to induce (but not to effect) transactions in securities by U.S. institutional investors or major U.S. institutional investors provided that the foreign broker-dealer (1) effects any resulting transactions through a U.S. registered broker-dealer that, among other things, (a) is responsible for issuing confirmations and statements to customers, extending margin or arranging for credit, receiving, delivering and safeguarding customer funds and securities, and complying with applicable U.S. net capital and recordkeeping requirements, (b) chaperones certain oral communications with U.S. institutional investors, (c) obtains certain biographical and disciplinary information and consents to service of process with respect to each associated person of the foreign broker-dealer that solicits U.S. investors ("foreign associated persons") and (d) maintains records with respect to foreign associated persons and transactions by U.S. investors and (2) agrees to provide certain information on request of the SEC with respect to the transactions. All foreign associated persons must conduct their activities from outside the U.S. (except for visits that are chaperoned by the U.S. registered broker-dealer and limited unchaperoned visits with major institutional investors) and may not, in the determination of the U.S. registered broker-dealer intermediating the transactions, be subject to certain disqualifications.

Unlimited Activities with Selected Investors: This exemption permits foreign broker-dealers to induce and effect transactions in securities by (1) a U.S. registered broker-dealer (acting as principal or agent) or a bank operating under an exception of exemption from registration as a broker-dealer, (2) the United Nations, IMF or other specified international organization, (3) a foreign person temporarily present in the U.S. with which the foreign broker-dealer had a *bona fide* preexisting relationship, (4) an agency or branch of a U.S. company permanently located outside the U.S. provided the transactions take place outside the United States and (5) a U.S. citizen resident outside the U.S. provided the transactions take place outside the United States and the foreign broker-dealer does not specifically target U.S. residents abroad.

The Proposed Amendments

The SEC proposes making the following changes to these provisions:

Unsolicited Transactions

The proposed amendments would leave the unsolicited transaction exemption unchanged (including the broad definition of "soliciting'), except that the SEC would no longer consider solicitation to include a U.S. investor's receipt of foreign quotations by a third-party system that distributes such quotations primarily in foreign countries. (The requirements that the system not be controlled by the foreign broker-dealer or permit U.S. investors to execute transactions would be retained.)

Research and Related Transactions

The exemption permitting the distribution of research and related trades would be amended to change the class of investors to which it applies from "major U.S. institutional investors" to "qualified investors," a term already defined under the Exchange Act. (Indeed, "qualified investor" would replace the two investor categories – "U.S. institutional investor" and "major U.S. institutional investor" – currently used in the rule with respect to research and direct solicitation.) The principal differences between a "qualified investor" under the proposed rule and a "major U.S. institutional investor" under the current rule are the reduced threshold for invested assets – from U.S.$100 million to U.S.$25 million – and the inclusion of natural persons.

There is, however, a significant difference in the invested asset test under the definition of "qualified investor." The current definition of "major U.S. institutional investor" expressly includes a U.S. registered investment adviser with total *assets under management* in excess of U.S.$100 million, and SEC staff no-action relief expanded this definition to include any institution, including an unregistered investment adviser, that meets the assets under management test. However, the definition of "qualified investor" does not include a registered investment adviser. Moreover, the definition only encompasses natural and non-natural persons that both *own **and** invest* U.S.$25 million.

Solicitation of Investors

The proposed amendments would permit transactions with qualified investors and eliminate the chaperoning requirement for direct solicitations. Moreover, a foreign broker-dealer would no longer be required to effect any resulting transactions through a U.S. registered broker-dealer. The proposed rule would still require the intermediation of a registered broker-dealer for the purpose of (1) maintaining books and records relating to the transactions and, unless the foreign broker-dealer conducts a "foreign business," (2) receiving, delivering and maintaining custody of customer funds and securities. However, in a change from the existing rule, a foreign broker-dealer operating under this exemption would have to be regulated in its home country for conducting securities activities, including the specific activities performed for U.S. investors.

Foreign Broker-Dealers That Conduct A "Foreign Business" – Proposed Rule 15a-6(a)(3)(iii)(A)(1)

Under the so-called (A)(1) Exemption, a foreign broker-dealer that conducts a "foreign business" would be able to conduct what amounts to full service brokerage with respect to qualified investors, including the execution, financing and clearance and settlement of trades and the custody of customer funds and securities. A U.S. registered broker-dealer would be required to maintain copies of all books and records relating to the transactions, including confirmations and account statements. However, unlike the current requirement that the U.S. registered broker-dealer effecting the transactions maintain the books and records required under U.S. law in the United States (unless it is a non-resident registered broker-dealer in accordance with Rule 17a-7), the registered broker-dealer would be permitted to maintain them with the foreign broker-dealer in the form, manner and for the time period prescribed by foreign regulation, provided the registered broker-dealer determines that the records can be furnished promptly to the Commission and does so on request.

The chaperoning requirements under the current rule would be eliminated. The number of permissible "visits" would be increased to 180 days in a calendar year. The foreign broker-dealer would be required to disclose to the qualified investor that it is regulated by a foreign securities authority and not by the SEC, and that U.S. segregation of funds requirements, bankruptcy laws and SIPA protections do not apply to assets held by a foreign broker-dealer. The foreign broker-dealer would be required to determine that its associated persons dealing with qualified investors are not subject to any statutory disqualifications under the Exchange Act or other specified offenses and to maintain biographical and disciplinary information about such associated persons. (Under the current rule, the U.S. broker-dealer is responsible for performing these functions.)

As noted, this exemption is only available to foreign broker-dealers that conduct a "foreign business." Accordingly, at least 85 percent of the aggregate value of the securities purchased or sold by the foreign broker-dealer, calculated on a rolling two-year basis, must be derived from transactions in "foreign securities." The term "foreign securities" includes any debt or equity security of a "foreign private issuer," debt securities of U.S. issuers that are distributed wholly outside the U.S. in compliance with Regulation S, certain securities issued by foreign governments as well as derivatives on any of these securities. A "foreign private issuer" means any foreign company other than a company (1) that is majority owned by U.S. residents and (2) the majority of its executive officers and directors are U.S. citizens or residents, the majority of its assets are located in the United States or its business is principally administered in the United States.

Foreign Broker-Dealers Not Conducting a "Foreign Business" – Proposed Rule 15a-6(a)(3)(iii)(A)(2)

Under the so-called (A)(2) Exemption, a foreign broker-dealer that does not meet the "foreign business" test may conduct all securities activities with respect to qualified investors contemplated by the (A)(1) Exemption other than holding customer assets. In this regard, the foreign broker-dealer must use a U.S. registered broker-dealer intermediary to receive, deliver and custody funds and securities in connection with transactions by qualified investors. This exemption would not allow a U.S. registered broker-dealer to maintain copies of books and records relating to such transactions with the foreign broker-dealer. They must be maintained by the U.S. registered broker-dealer in the form, manner and for the time periods prescribed by U.S. law.

Like the (A)(1) Exemption: (1) there are no chaperoning requirements, (2) visits with qualified investors in the U.S. would be permitted up to 180 days, (3) the foreign broker-dealer would be required to make disclosure regarding foreign regulation (but not the disclosures relating to custody) and (4) the foreign broker-dealer would have to ensure that its associated persons dealing with U.S. investors are not subject to any disqualifications and maintain the biographical and disciplinary information prescribed by the rule.

Unlimited Activities with Selected Investors

The proposed rule would add U.S. resident fiduciaries of "foreign resident clients" to the existing categories of investors with whom a foreign broker-dealer may do business in the United States. A "foreign resident client" would be defined as: (1) any entity not organized or incorporated under the laws of the U.S. and not engaged in a trade or business in the U.S. for federal income tax purposes, (2) any natural person not a resident for federal income tax purposes and (3) any entity not organized or incorporated under U.S. law, 85 percent or more of whose outstanding voting securities are beneficially owned by the persons described in (1) or (2). However, the exemption with respect to U.S. fiduciaries of foreign clients would be available only if the foreign broker-dealer is conducting a foreign business as described above.

Important Subjects For Comment

We suggest that foreign broker-dealers currently conducting business in the U.S. pursuant to Rule 15a-6, especially those operating through an affiliate that is registered in the U.S. solely for that purpose, consider submitting comments requesting that the proposed rule be amended in the following respects:

Qualified Investors: Since investment advisers ordinarily do not *own* the securities they manage for investment or otherwise meet the criteria for a qualified investor, the proposed amendment would greatly curtail the use of the research and solicitation exemptions with respect to U.S. investment advisers acting on behalf of the accounts that they manage. **We, therefore, recommend comments urging expansion of the category of U.S. investors with whom foreign broker-dealers may distribute research, solicit and effect transactions to include investment advisers with assets under management of U.S.$25 million.**

Intermediation: Foreign broker-dealers that have established U.S. registered broker-dealer affiliates solely for the purpose of conducting business with U.S. investors in foreign securities under Rule 15a-6 could operate under the proposed (A)(1) Exemption without their registered affiliate (and the related regulatory expense and liability) but for the requirement that a registered broker-dealer maintain books and records with respect to transactions with qualified investors (even though the requirement may be satisfied by maintaining the books and records at the foreign broker-dealer). Since the registered affiliate would no longer be required to effect the trades, provide margin, custody assets (or provide any other services typically performed by a broker-dealer) and the books and records maintenance requirement could just as effectively be performed by the foreign broker-dealer pursuant to an undertaking with the Commission, **we recommend comments urging elimination of the intermediation requirement for foreign broker-dealers that conduct a foreign business.**

Foreign Business: **We recommend comments urging simplification of the foreign business test by changing the reference securities from "foreign private issuers," which may require extensive due diligence regarding the issuers' shareholders, management and business operations, to "foreign issuers," which would merely require inquiry into the issuers' place of organization.**

Interpretation Permitting the Distribution of Research to Non-Qualified Investors: **We recommend comments urging confirmation of the continued application of the interpretation permitting foreign broker-dealers to distribute research reports to any U.S. person through a U.S. registered broker-dealer that accepts responsibility for the contents of the research.**

Of course, foreign broker-dealers may also wish to comment on other areas of concern specific to their business and operations.

Please do not hesitate to contact us if you have any questions with respect to the proposal or require assistance preparing comments.

BOCA RATON • BOSTON • CHICAGO • LONDON
LOS ANGELES • NEW ORLEANS • NEW YORK • NEWARK
PARIS • SÃO PAULO • WASHINGTON, D.C.

Client Alert

Proskauer's Broker-Dealer and Investment Management Group counsels major financial institutions, including full-service and boutique brokerage firms, domestic and foreign investment banks, investment advisers, investment companies, business development companies, hedge funds, private investment funds and banks, on securities regulatory matters, corporate and investment company governance issues, capital markets transactions, internal investigations, regulatory investigations, civil enforcement proceedings, criminal prosecutions, arbitrations and complex litigations. The members of the Group, led by our partner Kathy H. Rocklen, bring to bear their substantial experience and expertise gained through private practice, and service as securities regulators, general counsels and chief compliance officers for major investment banks and mutual fund complexes, and as professors of securities law.

For more information, please contact:

Benjamin J. Catalano
212.969.3980 – bcatalano@proskauer.com

Kathy H. Rocklen
212.969.3755 – krocklen@proskauer.com

Edward A. Kwalwasser
212.969.3515 – ekwalwasser@proskauer.com

Proskauer Rose is an international law firm that handles a full spectrum of legal issues worldwide.