News Bulletin

July 8, 2008

SEC Proposes Broader Access by Foreign Broker-Dealers to U.S. Investors

Background

Under Section 15 of the Securities Exchange Act of 1934 (the "Exchange Act"), any person engaged in the business of effecting securities transactions in the United States for his own account or the account of others is required to register with the SEC as a broker-dealer. As interpreted by the SEC, this requirement applies to foreign broker-dealers that solicit customers in the United States, even if the resulting transactions involve foreign securities and will be effected outside the United States. Foreign broker-dealers wishing to do business with U.S. customers were faced with a choice of registering with the SEC, establishing a subsidiary or affiliate in the United States that would register with the SEC, or severely limiting the scope of their contacts with U.S. customers (for example, only dealing with foreign branches of U.S. companies or U.S. persons traveling overseas).

Recognizing the increasingly global nature of the world's securities markets, in 1989 the SEC adopted Rule 15a-6 which was intended to permit foreign broker-dealers to engage in limited activities in the U.S. without having to register with the SEC. Under Rule 15a-6, foreign broker dealers may undertake the following activities:

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

Although Rule 15a-6 provides foreign broker-dealers with some access to U.S. customers, that access is very limited except in the case of Institutional Investors and Major Institutional Investors. Moreover, even contacts with these investors is subject to procedural requirements that impose burdens on the process, such as a requirement that an associated person of a U.S. broker-dealer chaperone the foreign broker's representatives when they visit their U.S. customers. (In 1997, the SEC relaxed the chaperoning requirements with respect to visits to Major Institutional Investors.)

On June 27, 2008, the SEC proposed a major liberalization of Rule 15a-6. If the proposed rule changes are adopted substantially as proposed, foreign broker-dealers would enjoy access to a much broader segment of the U.S. market and many of the procedural requirements would be rationalized to eliminate unnecessary burdens. In proposing these changes, the SEC noted that many U.S. customers want greater access to foreign broker-dealers in light of their perceived expertise in foreign securities markets. The SEC also noted that it believes there

are approximately 700 foreign broker-dealers who would engage in business with U.S. customers under Rule 15a-6.

The principal changes proposed by the SEC are summarized below.

Access to Qualified Investors

Under the proposed rule changes, foreign broker-dealers would be permitted to solicit business with "Qualified Investors" as defined in the Exchange Act. In addition, they would be permitted to provide research reports to Qualified Investors.

The definition of Qualified Investor includes natural persons, companies and other organizations with at least $25,000,000 of investments. The definition also includes those categories of investors currently within the definition of Institutional Investor as well as trusts and pension plans if the investment decisions for the trust or pension plan are made by an investment adviser, bank, savings and loan or insurance company.

This proposed change would substantially expand the universe of U.S. investors who might be solicited by foreign broker-dealers (currently limited to Institutional Investors and Major Institutional Investors) as well as the universe of U.S. investors to whom the foreign broker-dealer may send research reports (currently limited to Major Institutional Investors).

Elimination of Chaperoning Requirements

If the proposed changes are adopted, foreign broker-dealers would no longer need to be chaperoned by U.S. broker-dealers when visiting customers or prospective customers in the United States. In light of the proposed elimination of the chaperoning requirement, the SEC has suggested the need for a ceiling on the number of days that a person associated with a foreign broker-dealer could visit with customers in the U.S. The SEC's current suggestion is that such visits would be limited to 180 days in any calendar year. Anyone conducting visits in excess of this limit would be deemed to have established a permanent presence in the U.S. and would not be eligible for the exemption provided by Rule 15a-6.

Reduced Requirements for U.S. Broker-Dealers to Act as Intermediaries

Rule 15a-6 currently provides that any securities transaction resulting from solicitation of a U.S. customer by a foreign broker-dealer must be effected by a U.S. broker-dealer. The SEC's position is that this requires the U.S. broker-dealer to establish an account for the U.S. customer and handle all aspects of the transaction, other than negotiation of its terms. Thus, the U.S. broker-dealer must execute the trade, issue required confirms and account statements, provide any credit and maintain custody of customer funds and securities. In addition, the U.S. broker-dealer is required to obtain consents to service of process from the foreign broker-dealer and its associated persons that solicit business in the U.S. and is required to confirm that such persons are not subject to certain statutory disqualifications under U.S. law.

While these requirements would continue to apply if the resulting transaction is effected on a U.S. exchange or with a U.S. market maker, the role of U.S. broker-dealers would be substantially reduced if the resulting transaction is effected offshore. If the foreign broker-dealer is engaged in a "foreign business" and the resulting transaction is effected offshore, then the intermediating U.S. broker-dealer is not required to establish an account for the U.S. customer. The role of the U.S. broker-dealer would be largely limited to obtaining the consents to service of process. In addition, the U.S. broker-dealer must "maintain" records of the resulting transaction, but such records can be maintained with the foreign broker-dealer as long as the U.S. broker-dealer confirms the SEC would have access to such records upon request. The foreign broker-dealer would be permitted to execute the trade and maintain custody of customer funds and securities. The foreign broker-dealer would be required to

make certain disclosures to the U.S. customer regarding the fact that it is not subject to regulation by the SEC, funds and securities in its custody are not subject to protection by SIPC and the customer will not have other protections provided by U.S. law. A foreign broker-dealer is deemed to be engaged in a "foreign business" if at least 85% of the value of its securities transactions, calculated on a two year rolling basis, are in foreign securities.

A foreign broker-dealer which cannot establish that it is engaged in a "foreign business" may also solicit transactions with Qualified Investors in the U.S. If the resulting transaction is effected offshore, then the foreign broker-dealer could execute the trade. However, the intermediating U.S. broker-dealer would be required to establish an account for the U.S. customer and would be responsible for issuing confirmations and statements and maintaining custody of the U.S. customer's funds and securities.

Next Steps

The proposed changes to Rule 15a-6 have been released and are subject to a 60-day period for public comment. The SEC has indicated in its release that it is seeking comments on virtually all aspects of the proposed changes. Therefore, interested parties are encouraged to review the proposed changes and consider the possibility of submitting comments during the comment period.

We would be pleased to consult on the potential impact of the proposed rule changes as well as with respect to comments that might be submitted. A further Client Alert will be issued upon finalization of the changes to Rule 15a-6.

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