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Jesriel (00:00):

Good afternoon. My name is Jesriel and I will be your conference operator for today. At this time, I would like to welcome everyone to the Current Practices and Issues for Foreign Broker Dealers under Rule 1586 in 2017 conference call. All lines have been placed on mute to prevent any background noise. After the speaker's remarks, there will be a question and answer session. If you would like to ask a question, simply press star one on your telephone keypad, and if you would like to withdraw it, please press the pound key. Thank you. Let me start Hillel Cohn. You may begin your conference.

Hillel Cohn (00:37):

Thank you very much, operator, and thank you everybody for attending today. We are going to review the basics of Rule 1586 and talk about some recent developments that affect the operation of the rule. My name is Hillel Cohn. I'm an attorney with Morrison and Forrester's capital markets practice and spend a lot of time advising financial institutions on compliance with U.S. securities laws. I formerly worked at DSCC, which is also the former employer of my co-speaker Francois Cooke, a managing director with ACA compliance, who, in addition to working at the SEC, worked at the NASD and for a big four accounting firm, where he was a partner in their financial regulation practice, prior to joining ACA. So the two of us will be discussing these topics today. We invite your questions at the end of the session. For those who would prefer to submit a question in writing, please feel free to do so. You can send it after the session to Trevor Star, who sent the packages to you for today's presentation, and we will be happy to follow up with you by email and try and answer any questions you might have. Let me start by reading the CLE code. For those of you who are looking for COE credit, it should be certified in both New York and California. And the number is 1703-80. Okay, so let's talk about what the basics of rule 1586. Stepping back, the—as most of you know, if you engage in the business of effecting securities transactions, either for others or for yourself, you may very well be a broker dealer as defined under U.S. securities laws. And as a broker dealer, you would be subject to the registration requirements of the SEC, you would have to join FINRA, you'd be subject to state registration requirements—all of which, as many of you know, is a very detailed and cumbersome process, which certainly would want—one would want to avoid if not truly necessary for the conduct of the business. Recognizing that the broad definition of broker dealer that is set forth in the securities exchange act might impair the accessibility of investors in the United States to investment brokerage services offered by foreign financial institutions, and recognizing that we are increasingly operating in a world where financial services are offered on a global or certainly international basis, and that many investors, both institutional and retail, want to have a significant international component in their investment portfolio. In 1989, the SEC adopted Rule 1586. The purpose of the rule is to define a limited category of conduct, which may be carried out by foreign brokers in foreign banks, operating in a brokerage capacity, touching the United States in various ways, which we'll go through without subjecting those foreign entities to the requirement to register as a broker dealer in the United States.

Hillel Cohn (04:46):

As you will see, as we go through today's presentation, the rule is showing a bit of age. It is, as I said, adopted in 1989. The SEC in 2008 proposed a rather significant revision to 1586. Unfortunately, that revision was released—a proposed revision was released a couple of months before the Lehman Brothers collapse, and nobody paid any attention to it. Thereafter, efforts to resurface it, I think, have been swamped by all the requirements to write new rules that came out with the Dodd-Frank Act and the JOBS act. And as a result, the revision of 1586 has never taken place. However, the SEC staff has tried to keep it relatively sensitive to new market developments through a number of important, no action letters and FAQ's, which have been issued over the years, and we will mention a number of those as we go through our presentation.

Hillel Cohn (06:02):

So what does Rule 1586 permit? There are four basic categories of conduct touching the United States, which are permitted under the rule. The first, and we'll go through each of these in more detail, but first I'll go through the foreign summary. The first category is that a non-U.S. broker dealer or bank, and I'm now on slide two, may affect transactions with any person in the United States. If the transaction was not solicited by the foreign broker. The concept here being, if somebody in the United States affirmatively reaches out to a broker dealer or bank in London or Tokyo, they are not expecting to have the protections of the broker dealer regulatory regime, which has been developed by the SEC. And the foreign broker dealer or bank should be free to deal with them. The second general category relates to research reports and the rule permits research reports to be furnished to what are defined as major institutional investors in the United States.

Hillel Cohn (07:20):

So this is an area where the foreign broker or bank is permitted to push its product to the U.S. clientele, but only to U.S. clients or prospective clients who would qualify as major institutional investors. And that definition is basically financial institutions in other entities, which have at least 100 million of financial assets. Financial assets is defined to include cash. So while the defined category of major institutional investors is similar to what you might be used to dealing with and referred to as quips or qualified institutional buyers in terms of 144A distributions, there are some minor differences in that you could be a major institutional investor without qualifying as a Quip because of a significant component of financial assets that did not qualify as investments under the definition of a qualified institutional buyer. The third general category, and perhaps the most broadly used category under Rule 1586 is the category which permits the foreign broker or bank to reach out affirmatively to U.S. major institutional investors and to other U.S. institutional investors to solicit securities transactions. And the category of people who are eligible for such affirmative reach out by the farm broker or bank, as I mentioned, includes major institutional investors and other U.S. institutional investors, which includes the usual suspects, paints, insurance companies, savings and loans, registered investment companies. It also includes a number, but not all, of the institutional accredited investors under Regulation D, and primarily we're dealing here with private business development companies, trust charitable organizations, and a handful of other institutional accredited investors under Regulation D. But not all institutional accredited investors are within the category of U.S. institutional investors, so you have to look at the definition carefully if it's not a major institutional investor to ascertain that they, in fact, qualify for affirmative solicitation efforts by the foreign broker. And the last category is a category where Rule 1586 in effect permits unfettered contact in transactions with certain categories that are defined as not requiring the protection of the U.S. broker dealer requirements. That would include U.S. broker dealers and banks, bona fide foreign branches of U.S. companies that are located outside the United States, U.S. persons who are residing

outside the United States, and, we'll talk about this in greater detail later, persons who are not U.S. nationals who are temporarily in the United States. So now I'm going to turn it—oh, I'm sorry. Let me first go through the unsolicited accounts on slide three.

Hillel Cohn (11:20):

So as mentioned, this is the first of the four categories enrolled 1586 of permitted conduct in the United States. And although it would appear to be rather broad because it permits the foreign broker or bank to deal with any U.S. person institutional or otherwise who approaches the foreign broker on an unsolicited basis. In fact, the utility of this particular prong of the rule is rather limited. And the first reason for that is that the SEC interprets solicitation very broadly. Has included any affirmative effort by the foreign broker or bank to establish a business relationship or to induce a trade with a U.S. person. So even limited advertising that was directed into the United States could result in a determination that the customer's contact to the foreign broker dealer was in fact solicited rather than unsolicited.

Hillel Cohn (12:34):

If you do, however, receive an unsolicited inquiry from a U.S. investor, what kind of communications can you have with them after you affect their trade? And in [**inaudible**] this was always an area of some mystery because clearly once you affected a trade for the U.S. person, you had an obligation to communicate with them, but you didn't want to do so in a manner that would then be deemed solicitation and therefore disqualify you from future business with that individual or that institution. So the SEC in FAQ issued in 2013 clarified that the foreign broker, after having effected a transaction on an unsolicited basis for a U.S. person, could in fact issue the usual documentation, such as confirmations, account statements, pass through issuer announcements and the like, without being deemed to have engaged in solicitation. Clearly, however, those mailings, if they're sent by mail should not be accompanied by any kind of advertising inserts, and anything sent by email should clearly be sent without any kind of links to advertising by the broker dealer or the bank, or you're likely to disqualify yourself from future business with the customer. The SEC staff in the 2013 FAQ's expressed some skepticism about whether or not it was practically possible to conduct ongoing business with a U.S. person on an unsolicited basis.

Hillel Cohn (14:24):

Clearly there's a challenge to doing that without crossing the line into solicitation, but from a point of view of the principle involved there's no reason why, if you carefully monitor your communications with a U.S. customer, you could not carry out a repeat business with that customer as long as they solicit and initiate all the transactions. Would that—

Francois Cooke:

Hello? Can I just put a quick point there? Because the keyword that you mentioned there was "challenged." So the clients I have that have 1586 arrangements is primarily because of these challenges that they've decided to just adhere to some of the other requirements. So, as you mentioned, monitoring of the communications and emails seems to be a challenge. Salespeople are going to be salespeople, which means they're going to often push the envelope. And one of the major challenges is just documented documentation to then demonstrate that you're only doing unsolicited trades and does not rise to the level of doing ongoing business. So I just wanted to throw that out, right?

Hillel Cohn (15:37):

I think those points are all very well taken. And in the last 10 years, I can only think of maybe a couple of instances where clients had actually engaged successfully in unsolicited transactions with U.S. customers under Rule 1586, which clearly is not a heavily used portion of the rule. With that I'd like to turn it over to Francois who will continue with a discussion on research reports.

Francois Cooke:

Sure. Thanks. So let's go to slide number four, and this is another element of the rule that is used very often, and it has to do with the dissemination of research reports by foreign brokers. Now, the kind of reports that are usually pushed out, as often through the means of email besides just the old-fashioned mailing method. And the rule does allow for dissemination to, as it's referred to here as MII's—those are the major institutional clients. However, it—those present challenges, too, and there are some limitations, which are very well-described and it's in question number five in the FAQ's that was distributed. Basically if you do have an arrangement already with a 1586 arrangement with another broker dealer, then you basically are going to have to comply with the other requirements, which we'll discuss in a moment. But just to really reiterate, major foreign brokers can disseminate directly to a major institutional clients.

Francois Cooke (17:46):

One of the things that I wanted to mention, though it's not often used, is this concept of broadly available information. So if the foreign broker dealer has a couple of disclosures, which indicate that services are not offered to you as persons, and there's no brokerage of services they can advertise on or have information that's broadly available on a website. However, this tends to defeat the purpose because generally the brokers are trying to get access to these major institutions. So one of the things that is on the slide has to do with that the research reports regulation AC does apply to them to the reports, except, which is the next bullet there, when there's a discussion in non-U.S. securities and the broker is not affiliated. I still see that a lot of firms trying to be conservative will make sure that they have the adequate disclosures and try to comply with these applicable requirements like regas AC as much as possible.

Hillel Cohn (19:12):

I wouldn't—I would add to that, that in our experience, many of the foreign banks that distributed research, and that would not be required to comply with regulation AC have in fact elected to do so voluntarily because they view it as the best practice standard, which a U.S. institutional investor would expect. And therefore they're going to put in the kind of disclosures that regulation AC would require, notwithstanding the fact that they're not legally obligated to do.

Francois Cooke:

That's a really good point. And we'll see, as we're going along, that it does pay to be more conservative than not. I did want to go on a really quick tangent regarding licensing, cause I get this question sometimes whether the individuals preparing the report needs to be licensed under [**INAUDIBLE**] 1050, that's one zero five, zero F. There is an exception from licensing when there's globally branded or the analyst is a foreign affiliate of the broker dealer. So I wanted to make the—make sure everyone was avail—aware of that in case you did have that question.

Hillel Cohn:

And how would you describe global branding?

Francois Cooke:

Yeah, global branding. One of the–I think the elements of it has to do with it being—usually it's an affiliate—affiliated relationship globally where the information provided is of a nature that goes across the sectors and is broader based.

Hillel Cohn:

Right. And where there there's, from the reader's perspective, it's not readily apparent that there is a distinction between the origin of the research on the U.S. broker dealer that might be involved in the distribution. So certainly the use of a global brand or such as the bank's name on the research, if it's a foreign bank, might tend to lead to a conclusion that you've caught a globally branded product.

Francois Cooke (21:47):

And the role actually talks about partially entirely prepared by foreign research analysts. And there are a couple of additional disclosures that would have to be made. So it's just very important to cross the T's, dot the I's, and look at the different elements of Rule 1050, if you do choose not to license, which happens quite often. Moving on to—I think we need to make sure we distinguish between third-party research and then research, which the U.S. broker dealer is basically taking responsibility for. So if the research report has not been controlled in any way by the U.S. broker dealer, and it's just passing along the information, then it doesn't have to take responsibility if it's a non-affiliated entity. However, if it—if they want to brand it in the broker dealer's name or it's disseminating to non-major institutions, then the U.S. broker dealer is going to have to take responsibility and disclose that responsibility in the material.

Francois Cooke (23:11):

So let's move on to slide number five, but this goes into those instances when third-party research is a choice. And in some instances you might have different arrangements where you are taking responsibility and other relationships when you're just using the third-party research. As indicated in the bullets, the disclosures need to be clearly labeled that it's third party, and the broker dealers is not participating in the preparation of the report, as I mentioned before. In addition to that FINRA also has a rule that addresses the third-party usage. In the last bullet there, it's—these are new coded rules to equity under rule 2241 and fixed income under rule 2242. And basically there are additional disclosures, which are listed above. Notably, any conflicts or ownership over 1% market-making in any investment banking activities that would be required by those FINRA roles.

Francois Cooke (24:31):

And the last thing on there is just an identification of potential benefits of globalized legends. The feedback I get, and, Hillel, I'll be interested in hearing what your—you might have insights to. The whole branding is really important for a particular name to go across regions, especially when they're affiliates. The efforts to cross sell and to get into other clients with access to wanting to invest is really important. And so the branding and the having the global legends are very critical.

Hillel Cohn:

So I've actually had clients take very different positions on this. Some clients have said, "You know, we don't want to worry about whether or not any particular report needs the full set of legends, or can be restricted in terms of the legends that are included. So we're just going to set up a set of globalized legends that will meet the requirements of, let's say, the U.S., Japan, and the EU, and all our reports are going to have that so that we don't need to worry about who's distributing or where they're distributing or whether it's viewed as having a global legend"—oh, I'm sorry, a global brand. I've had other brokers, however, who have said quite clearly they don't want to go through the headache of assembling all the potential information that needs to be disclosed under the FINRA research rules if they don't need to. And they would rather take advantage of the third-party disclosure abbreviated disclosures, and therefore have chosen to go that route and have tried to avoid having a single set of global disclosure. So it's really, I think, just a business decision that is likely driven by a number of business factors rather than the legal issues alone. Since, you know, again, brokers with very similar footprints, in some respects, have taken just biometrically opposite approaches on this particular point.

Francois Cooke:

That was a really good point. I think I've wrapped up the research reports and I hand it back to you.

Hillel Cohn:

Thank you, Francois. So we're going to talk now on page six about the third prong of Rule 1586, which are solicited trades with institutional and major institutional investors. And slide six really just has a definition that we already went through.

Hillel Cohn (27:23):

So moving ahead to slide seven—

Francois Cooke:

I'm sorry, Hillel, I have a really quick comment. I know one of the exercises is the documenting process of identifying which category the clients fall into. I've noticed that the maintenance of these lists are really important, especially when we decide how the foreign broker's going to interact, especially if they come to visit, it's really important to understand which institutions fall into which definition. So I just wanted to throw that out.

Hillel Cohn:

I think that's a very important point. And some people I've worked with have basically said, "You know what, we're just gonna–we don't want to deal with the category of institutional investors who don't qualify as MII, and we already have equivalent prepared by ideologic or another service. And we're just gonna deal with quibs. And we know that if it's a quib, it's going to be an MII, so we're safe. Others have tended to have a greater interest in exploring business opportunities with U.S. institutional investors who are not necessarily MII's and therefore they need to be attentive to documenting the status of that particular U.S. customer under the relevant definition and make sure that they fit the right category. Moving then to slide seven, the whole point of this particular prong is basically to allow the foreign broker to actively solicit and develop business with U.S. institutions who are interested in investing in

foreign securities. And although active solicitation by the foreign broker or bank is permitted, this prong of the rule does have a number of conditions, which must be complied with in order to stay within its bounds. Among other things, there's generally a requirement to have a U.S. broker dealer who will intermediate in various respects with respect to the anticipated transaction with a U.S. institutional investor. Among other things, the U.S. broker dealer is supposed to chaperone communications between the foreign broker and the U.S. institutional investor. However, there is an exception for communications with major institutional investors, which does not require chaperoning and which actually, and this was—these are exceptions developed by no action letters, which actually allows the foreign broker or banker to conduct in-person visits in the United States with institutional investors for up to 30 days a year without violating the requirements of the rule, provided that they don't accept any orders. And this can be a little bit tricky, but they have to be careful that when they visit they're soliciting, but they don't accept orders and defer the order taking process either to their U.S. intermediating broker or to communication where the U.S. intermediating broker is present.

Francois Cooke:

Hello, can I just throw in a couple of things. One thing I know from, and it's always the devil in the details. So the three things I see firms really at least grapple with upfront is who's going to actually, or the number of people in the organization that will be involved in the chaperoning itself, and who's reviewing the communications. And then how is it documented? And how is it tracked? So there does have to be a process and system set up as part of these arrangements.

Hillel Cohn (31:48):

So that actually is a good segue to what I want to mention towards the bottom of slide seven, which is that irrespective of whether the U.S. broker dealer is involved in the solicitation via chaperoning, the account that will execute the trade is going to be carried at the U.S. broker, and the U.S. broker is therefore responsible to make sure that all of the requirements that it would apply to any other account are, in fact, applied to this account, which would, of course, include AML, know your customer reasonable basis suitability, customer specific suitability, unless you have an institutional account waiver. So all these things are relevant to accounts, which may be carried at the U.S. broker dealer for purposes of effecting transactions that were initiated by the foreign affiliate. The trade actually has to settle through the U.S. broker dealer unless the transaction is in a foreign security or a U.S. government security, in which case settlement through the foreign broker dealer is permitted. And same thing with confirmations. The foreign broker dealer can issue confirmations in the case of foreign securities or U.S. government securities, but it's still the U.S. broker dealer's responsibility to make sure that confirmations that are compliant with U.S. law are timely issued to the U.S. institutional customer. So what you have is, in effect, a—under this prong of the rule, a sharing of the responsibility for the transaction, where the sales efforts are undertaken primarily, or perhaps entirely by the foreign broker, but the paperwork and the documentation and the execution responsibilities will either fall to the U.S. broker dealer or the U.S. broker dealer needs to monitor it and make sure that everything is being effected and documented properly. And any failing in this regard will be potentially a problem for the U.S. broker dealer. So U.S. brokers have to be actively involved in these transactions. And in that regard, and I'm moving now to slide eight—

Francois Cooke:

I'm sorry, I apologize. Did we mention that there has to be a sales ledger—is an actual books and records that would have to be prepared. And I—and I hate to get into the financials, but potentially the firm has to consider to take a fails charge to their net capital if it exceeds certain time periods.

Hillel Cohn:

That's right, because it's in effect the transaction carried on the books of the U.S. broker. So all the capital and everything else is potentially implicated by the transaction. Moving to slide eight, the—we think it's really important where you will have transactions under this prong of the rule. That there'd be a written agreement between the U.S. broker and it's for an affiliate or its foreign correspondent in order to make sure that everybody understands what they are doing and to set up a proper protocol so that the implementation of trades that are solicited by the foreign broker are, in fact, carried out in a manner that's compliant with U.S. requirements.

Hillel Cohn (36:06):

So we think that written agreement needs to specify. It needs to allocate responsibilities between the U.S. broker, and the foreign broker needs to specify what role the U.S. broker will have in either participating in or monitoring communications between the foreign broker and the U.S. institutional investor provides the U.S. broker with an adequate opportunity to address issues such as reasonable basis, suitability, AML, and the like. And it sets forth all the information that's necessary for onboarding the U.S. institutional client, which again, is being carried at the U.S. broker, notwithstanding the fact that the sales relationship may reside with the foreign affiliate.

Francois Cooke:

And Hillel, I think these are really great point on the written agreement. I've seen that there's like a regulatory expectation to see such an agreement when there are examinations, because I've found that it's really difficult to demonstrate what the relationship is with the foreign brief broker if there isn't an agreement. I don't know if you've had a different experience.

Hillel Cohn:

No, we—I've had a similar experience. And interestingly, although I think PSEC tends to focus on this rule more than FINRA, FINRA examiners asking about documentation on 1586 transactions to make sure the U.S. broker is actually discharging their responsibilities under the rule. Moving on then to slide nine. Let's talk about Rule 1586 in the M&A context. And this is again part of prongs three, the provision of 1586, which allows affirmative communications and affirmative solicitation by the forum broker to the U.S. institutional investor.

Hillel Cohn (38:25):

First point of course, is that unless you are able to fit your transaction within the private M&A brokers' no action letter that came out about three years ago, you should assume if you're involved in an M&A transaction, the broker dealer rules apply. And if you're a foreign broker dealer, you're engaged in an M&A transaction with a U.S. counterparty, you need to be mindful of that in terms of how you go about carrying out your responsibilities in connection with the M&A transaction. The SCC has provided some help in this regard through a couple of no action letters that were issued in recent years. In one of them,

the Ernst and Young global no-action letter, which is part of your materials, they took the definition of major institutional investor, which, you'll remember, it was a hundred million of financial assets, and said that in the context of advice involving an M&A transaction or a corporate financing transaction, the U.S. entity could be measured by total business assets, excluding cash.

Hillel Cohn (39:54):

So it was no longer being looked at as an investor so much as a corporation undertaking a strategic transaction, either on the M&A front of the corporate financing front and engaging with a foreign broker dealer or a bank for advice in respect of that transaction. And in that regard, the SEC agreed that it made more sense to measure the sophistication and capability of that entity by their business assets, not their financial assets. And so if they had a hundred million of total assets excluding cash, they can be treated as an MII under rule 1586, and the foreign broker can interact with them as they would with any other major institutional investor. Then in the Roland Berger no action letter, the SEC also took the position that, in addition to being able to deal freely with foreign broker—with U.S. broker dealers, which foreign broker dealers can always do, they could also deal with the in-house M&A team at a U.S. major institutional investor.

Hillel Cohn (41:16):

So if you're a foreign broker dealer and you have a potential U.S. counterparty to an M&A transaction as represented by Goldman Sachs, you've—foreign broker dealer's always been permitted to deal Goldman Sachs. That's prong four of Rule 1586, and there's never been any limitation on that level of interaction. However, if you had a large U.S. company, which doesn't use a U.S. investment banker, and as many of you know, this is not uncommon today with some of the very largest U.S. companies, but has their own in-house M&A team, under the Roland Berger letter, the foreign broker dealer doesn't have to deal with a U.S. broker. They can deal directly with the M&A team at the U.S. MII and be protected in terms of their dealings under Rule 1586 and not need to be concerned that they're somehow violating the requirements.

Hillel Cohn (42:30):

So there is a, I think, a recognition by the SEC that the M&A context is somewhat unique and should be afforded somewhat—foreign broker dealers should be afforded a somewhat broader path for dealing with U.S. investors and institutions in that context. Moving on to slide 10, this is category four of Rule 1586. We mentioned that the foreign broker dealer or bank can deal freely with U.S. broker dealers and banks. And that's true whether or not the foreign broker dealer is acting as a principal or as an agent for its customer. In addition, under some of the no action letters that have come out, the foreign broker dealer may conduct business freely with a fiduciary resident in the U.S. which is acting on behalf of one or more non-U.S. customers, if those dealings are in relation to non-U.S. securities.

Hillel Cohn (43:48):

And also, as we mentioned at the outset of the presentation, it's permissible to deal with the legitimate bona fide, off-shore branches or offices of a U.S. company. So if you're a Japanese bank, you're allowed to deal with a—the Tokyo branch or office of a U.S. company, provided that it was set up for legitimate business purpose and not simply to circumvent the broker dealer requirements. But bear in mind in those cases where you're dealing with an offshore branch or office that the—any resulting transaction must be effected outside the United States. Moving on to slide 11, the rule has always permitted the U.S.–I'm sorry. It's always permitted foreign broker dealers to deal with foreign individuals who are

resident in the United States on a temporary basis. However, that was not very clearly defined, and there was some language in the adopting release, which made it sound like unless the foreign person was just on a vacation in the United States or something of that brevity, that there was some risk in dealing with them. In the FAQ, as it came out in 2013, the FCC provided some helpful clarity and said, "No, if the foreign person is—was your customer before they came to the U.S. and they're in the U.S. even for an extended period, but they're not a citizen, and they're not a green card holder, then it's permissible to continue to do business with them."

Hillel Cohn (45:39):

And we've actually seen a fair amount of activity under this prong of the rule where foreign broker dealers conduct transactions with expatriate executives or present in the United States for an extended term. And finally we have the provision that permits the foreign broker dealer to carry out business with a U.S. national who was a resident outside the United States. Again, these are transactions which have to be effected outside the United States. And it's important to bear in mind that when that U.S. national returns to the U.S., you no longer have the protection of this prong, and the foreign broker dealer either has to solicit—it has to cease doing business with that U.S. person, or only do business with them on an unsolicited basis.

Hillel Cohn (46:37):

Slide 12 with some of the more recent enforcement cases. There was one significant Rule 1586 enforcement case last year, and that involved Bank Leumi, the Israeli bank, which was found to have solicited more than 200 persons resident in the U.S. over a 10 year period. The Bank Leumi case is similar to the Credit Swiss case and the HSPC case, and some other cases involving foreign banks, where the—typically, it was the private wealth arm of the foreign bank, which was dealing with high net worth individuals in the U.S. In some cases, simply U.S. persons who were looking for opportunities to have their money managed by persons outside the U.S., in some cases persons who had originally come from the home country of the bank and who wanted to continue to deal with that particular bank, but in any respect, the dealings were with high net worth individuals who did not qualify as MII's, and there was unquestionably an effort to solicit their business, clearly activity prohibited under Rule 1586.

Hillel Cohn (48:12):

So in these cases, as you can see from some of the examples listed on slide 12, the penalties could be rather significant. The interesting thing about the Bank Leumi case is that apparently, for the first half of this ten-year period, Bank Leumi was either unaware of the requirements of Rule 158 or wasn't paying much heed to them, but they became aware of the issue in 2009 and took steps to try and terminate their conduct in the U.S., which violated rule 1586. And as the SEC action sets forth—and it's part of your materials—it took quite a few years for Bank Leumi to actually wrap this up and closed down. In fact, I don't think it was ever fully closed down until they sold their private wealth business to a Swiss bank. They had resistance, not only from some of their brokers who didn't want to give up the clients, but they also had resistance on the clients in the U.S. they didn't want to give up their relationship.

Hillel Cohn (49:27):

So the process of trying to self-correct took quite a few years, and that was problematic.

Francois Cooke:

Hello, can I just highlight there's one word sticking in their training, which I don't think should be underestimated. I do believe that after the initial start of having 1586 arrangements, there's no further training or discussion of it as time goes on. And since there is this exception, this exemption is complex. It is worthwhile that, at least some time during the year, there's a discussion of how the, what the firm's processes are to comply with the rule, especially if there's like case studies that the firm actually has to share with the people that are involved with the process.

Hillel Cohn:

Yeah, I think that's right. And again, I think the Bank Leumi case shows the sad outcome of a situation where the lack of training in early years proved hard to overcome, even when the bank recognized they needed to change what they were doing and made efforts, which were not entirely availing ,to cut off the prohibited business in the United States.

Hillel Cohn (50:58):

The last case on slide 12, I have included there simply to indicate that other than just the issue of "you're doing business unlawfully in the United States," there are some cases, and this was a FINRA case, where the execution of transactions under 1586 was not—was defective and not fully compliant with the requirements. In this case, the issue was that UBS was relying on its foreign affiliate to issue confirmations on transactions in foreign securities. And in fact, the confirmations were not always being timely issued, and UBS had not actively monitored and timely prevented that misconduct. So to Francois's point, if you are the U.S. intermediating broker, it is important to make sure your people are well-trained and understand what their responsibilities are when they are acting as the intermediating broker on Rule 1586 transactions. Moving on to slide 13, we've just listed some of the topics which have come to us in the past year or so on 1586 issues from various clients. we've talked a little bit about the whole issue of research reports and global branding and how clients have taken very different approaches to address this issue.

Hillel Cohn (52:37):

I think it's an issue, which is challenging because the definition of what constitutes a global brand is not very clear and requires some judgment. And of course, the consequences of determining that you do have a global brand are significant. So it is an area that is worthy of some attention. Cross border M&A—

Francois Cooke:

I'm sorry. Hello. Just one quick point on the research reports. I think the firms that I found to be more successful regarding research reports have a formal process, a formal flow, of how the research reports are disseminated, no matter which choice you take of either a direct dissemination, whether it's third-party or whether the firm is taking direct responsibility. It's important that there's a formal process flow, and everyone understands the role they play in that flow.

Hillel Cohn:

And the—obviously, that procedure should be properly documented.

Francois Cooke:

Right.

Hillel Cohn (53:46):

And again, if you're the U.S. broker and you're doing the distribution, then you'll want to make sure you've got in place, cause you still have to do a—even if it's a unaffiliated research report you're distributing, you still have your basic obligations under FINRA to kind of do a red flag check and make sure that the content appears to be objective and balanced and properly resourced and not the type of report, which is going to get you in trouble for distributing communications, which are not trustworthy and reliable. In the cross border M&A context, I think the—there are always challenges in terms of identifying what the respective roles of the foreign broker and any U.S. affiliate will be in carrying the transaction forward. It's a lot easier because of the recent SEC, no action rules for the foreign broker to represent a foreign company that is engaging with a U.S. counter party in a potential M&A transaction.

Hillel Cohn (54:58):

It's a lot more challenging if—but not impossible—if you want to represent a U.S. party that is looking to engage with foreign counter parties in an M&A transaction. Transactions with global fund managers are—again, it's important to identify where is the customer and where is the order being generated from? And sometimes this is not transparent. That's something which needs to be thought about in terms of whether or not you're dealing with, in fact, a foreign manager as a foreign customer, or whether or not you're dealing with an underlying U.S. customer. And finally in row 144, a transactions, as we talked about, it's really important for the U.S. intermediating broker to understand their responsibilities in those transactions, which will be affected through them, notwithstanding the fact that the sale may be may be largely done by the foreign affiliate, the paperwork and the account's going to be carried at the U.S. broker for bookkeeping purposes. So with that, we have just a couple of minutes for some questions. If anyone has one

Jesriel (56:29):

At this time, I would like to remind everyone in order to ask a question, please press star. Then the number one and your telephone keypad. We'll pause for just a moment to compile the Q and A roster.

Hillel Cohn (56:41):

And while you're paused, I'll reread, the CLE number is 1703-80.

Jesriel (56:53):

Your first question comes from the line of David Ramsey. Your line is open. Please ask your question.

David Ramsey (57:00):

Hi, good afternoon, Hillel, Francois. It's been very helpful, the presentation this morning. I had a question concerning the 1586 exemption, the M&A context with the 2014 M&A broker no action letter. Is that a no action letter that you find many large institutions are relying on again, in the context where there is a foreign M&A client, or do you see it as something that is restricted to a different set of services than your traditional bulge bracket M&A practice?

Hillel Cohn:

So I don't see it a lot, but I have seen at least one case, a foreign bank that has some specialty areas of focus, which might result in their having M&A engagements for companies that went to qualify as MII's, but which are privately held and would therefore qualify for potential representation under the M&A no action letter.

David Ramsey (58:08):

That was helpful. Thank you.

Jesriel:

Again, if you would like to ask a question, please press star, then the number one on your telephone keypad. There are no further questions at this time. I will turn the call over back to the presenters.

Hillel Cohn (58:31):

So once again, thank you all very much. If you have questions you want to submit in writing, please feel free to do so, as I mentioned to Trevor who sent out to the packages, and we thank you for participating in today's presentation.

Jesriel (58:50):

This concludes today's conference call. You may now all disconnect.