Securities Briefing Series

WILMERHALE

Almost Two Decades Later: SEC Proposes Changes to Rule 15a-6, Taking Bold Steps to Liberalize Cross Border Regulation

On June 27, 2008, the U.S. Securities and Exchange Commission ("SEC") took significant steps to liberalize cross border securities regulation, proposing bold amendments to the foreign broker-dealer safe harbor from U.S. registration requirements, Rule 15a-6 (or the "Rule") under the Securities Exchange Act of 1934 ("Exchange Act").[1] The SEC's Proposal contains several important provisions that, according to the SEC, will significantly enhance the ability of U.S. investors to access non-U.S. securities markets and promote the efficient functioning of the international securities markets. At the same time, the proposed changes preserve certain important investor safeguards and protections. On the whole, the SEC's Proposal is a welcome development. For example, it generally would expand the category of U.S. investors that foreign broker-dealers may contact for the purpose of soliciting securities transactions and providing research reports. It also would reduce the role that U.S. broker-dealers must play in intermediating or "chaperoning" transactions effected by foreign broker-dealers on behalf of certain U.S. investors.

That being said, there are several areas of the Proposal that are in need of clarification (upon some of which the SEC has solicited comments). Also, in certain important respects, the SEC's Proposal is more limited than the current regulatory regime for foreign broker-dealer regulation. Below is a brief discussion of the regulatory background relating to the Rule, followed by a summary of the key aspects of the Proposal, *i.e.,* (i) the new "qualified investor" standard, (ii) revisions to the scope of the "unsolicited transaction" exemption, (iii) revisions to the scope of the "solicited" transaction exemption, (iv) the provision of research from foreign broker-dealers directly to U.S. investors, (v) transactions with certain exempt counterparties, and (vi) limited exemptions for options exchanges.

Comments on the Proposal are due **September 8, 2008**.

I. Rule 15a-6: From 1989 to 2008

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 SEC. The SEC uses a territorial approach in applying the broker-dealer registration requirements to the operations of foreign

[1] Exemption of Certain Foreign Brokers or Dealers, Securities Exchange Act Release No. 58,047 (Jun. 27, 2008), 73 Fed. Reg. 39,181 (Jul. 8, 2008) ("Proposal").

broker-dealers.[2] Under this approach, foreign broker-dealers may be subject to SEC registration requirements if they induce or attempt to induce securities transactions with persons in the United States, even if those broker-dealers reside outside of the United States.

It has been almost two decades since the SEC adopted Rule 15a-6 in 1989.[3] Rule 15a-6 provides conditional exemptions for foreign broker-dealers from the registration requirements of Section 15(a) of the Exchange Act. In particular, the Rule exempts from registration foreign brokers that effect unsolicited transactions for U.S. investors or provide research reports to certain "major" institutional investors.[4] The Rule also exempts from registration foreign broker-dealers that solicit "permitted" institutional customers in the U.S. to buy or sell securities, provided that nearly every aspect of the relationship is intermediated by a registered U.S. broker-dealer.[5] Additionally, the Rule exempts from registration foreign broker-dealers that effect transactions for or solicit certain categories of persons, including registered U.S. broker-dealers, banks acting as broker-dealers, foreign persons temporarily in the U.S., and U.S. citizens resident outside the U.S.[6] Over the years, the SEC staff has expanded and modified the scope of Rule 15a-6 through a variety of no-action letters and interpretive guidance.[7]

II. Adoption of "Qualified Investor" Standard

The SEC's Proposal would eliminate the following two categories of permissible customers, with whom foreign broker-dealers may have limited contacts: "U.S. institutional investor" and "major U.S. institutional investor." The proposed rule would replace these categories with a single category of permissible customer: qualified investor.

Currently, a "U.S. institutional investor" includes, for example, a registered investment company or a bank, savings and loan, insurance company, business development company, small business investment company or employee benefit plan as defined in Regulation D under the Securities Act of 1933.[8] "Major U.S. institutional investor," in turn, is (i) a U.S. institutional investor or a registered investment advisor that, in either case, has more than $100 million in assets or assets under management, or (ii) any entity (including an unregistered adviser) that owns or controls (or, in the case of an investment adviser, has under management) in excess of $100 million in aggregate financial assets.[9] Foreign broker-dealers are permitted, without registration in the United States, to distribute research reports only to major U.S.

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2 *See* Registration Requirements for Foreign Broker-Dealers, Securities Exchange Act Release No. 27,017 (Jul. 11, 1989), 54 Fed. Reg. 30,013 (Jul. 18, 1989) ("Rule 15a-6 Adopting Release").

3 *See id.*

4 The term "foreign broker-dealer" is defined in the Rule 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 'broker' or 'dealer' in Section 3(a)(4) of the [Exchange] Act." 17 CFR 240.15a-6(b)(3).

5 Rule 15a-6(a)(3).

6 Rule 15a-6(a)(4).

7 In particular, the SEC has modified the scope of the "permitted" customers which foreign broker-dealers may solicit and allowed more direct contacts between foreign broker-dealers and permitted customers for transactions involving foreign and U.S. government securities. *See* Cleary, Gottlieb, Steen & Hamilton, SEC No-Action Letter (Apr. 9, 1997) ("Nine Firms Letter"); Bear Stearns & Co., Inc., et. al., SEC No-Action Letter (Nov. 22, 1995, revised on Jan. 30, 1996) ("Offshore Client Letter").

8 Rule 15a-6(b)(7).

9 Rule 15a-6(b)(4). This definition was expanded in the Nine Firms Letter to include "any entity" with more than $100 million in assets or assets under management.

institutional investors.[10] Even with complete intermediation by a registered U.S. broker-dealer, foreign broker-dealers are exempted from registration when they induce or attempt to induce the purchase or sale of securities *only by* U.S. institutional investors or major U.S. institutional investors.[11]

Under the Proposal, the term "qualified investor" would replace U.S. institutional investor and major U.S. institutional investor, thus expanding in certain respects the category of U.S. persons who may have direct and indirect (intermediated) contacts with foreign broker-dealers. "Qualified investor" is defined in Section 3(a)(54), of the Exchange Act to include:

(i) registered investment companies;

(ii) issuers excluded from the definition of investment company under Section 3(c)(7) of the Investment Company Act of 1940;

(iii) banks, savings associations, brokers, dealers, insurance companies, or business companies;

(iv) associated persons of broker-dealers other than natural persons; or

(v) corporations, companies, partnerships, or natural persons that invest on a discretionary basis at least $25 million in investments.[12]

This new standard is noteworthy, in particular, because it would reduce the threshold asset level for institutional investors from $100 million to $25 million and would permit foreign broker-dealers to deal with natural persons with $25 million in assets.[13] It is not clear, however, whether there may be certain entities excluded from this qualified investor standard, which would be captured by the broad, major institutional investor "catch-all" of "any entity that owns or controls in excess of $100 million in aggregate financial assets" (*e.g.,* certain trusts).

The SEC requested comment on a number of issues relating to the adoption of the qualified investor standard, in particular:

- *whether the qualified investor standard is appropriate; and*
- *whether natural persons should receive additional protections, such as increased involvement of U.S. registered broker-dealers*.

III. Unsolicited Transactions (Third Party Quotation Systems)

Currently, paragraph (a)(1) of the Rule provides an exemption from registration for foreign broker-dealers that effect unsolicited transactions for U.S. customers. The Proposal does not change this exemption, but includes new guidance regarding the SEC's broad interpretation of the term "solicitation," as that term applies to quotation systems.

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10 Rule 15a-6(a)(2).

11 Rule 15a-6(a)(3).

12 15 U.S.C. 78c(54). Note that the definition includes additional categories of investors not discussed here.

13 Note that the change would actually raise the asset threshold from $5 million to $25 million for some investors, including employee benefit plans and certain organizations described in Section 503(c) of the Internal Revenue Code.

In the 1989 release adopting Rule 15a-6, the SEC stated that it would not consider distribution of broker-dealers' quotations by third-party systems that distribute quotations primarily in foreign countries to be a solicitation, as long as transactions between U.S. persons and foreign broker-dealers could not be executed through the system. On the other hand, dissemination of a foreign broker-dealer's quotations through a proprietary quotation system controlled by the broker-dealer would *not* be appropriate without registration.[14] Dissemination of quotes in this fashion would be "a direct, exclusive inducement to trade with that foreign broker-dealer."[15]

In the Proposal, the SEC recognized that the distinction between systems that disseminate quotations primarily in the United States and those that disseminate quotations primarily in foreign countries is meaningless today.[16] It proposed to update its guidance to state that U.S. distribution of a foreign broker-dealer's quotations by any third party system—regardless of where it primarily distributes quotations—would not be considered a solicitation for broker-dealer registration purposes, provided that transactions between the foreign broker-dealer and U.S. persons could not be executed through the system.[17]

The SEC requested comment on this portion of its Proposal, asking:

- *Should paragraph (a)(1) be further modified to reflect increased internationalization of the securities markets?*
- *Are there other interpretive issues relating to quotation systems that the SEC should address? (For example, should the SEC issue guidance regarding the interpretation of solicitation as applied to other entities, such as systems that provide indications of interest?)*
- *Should the SEC amend Regulation ATS to allow a foreign broker-dealer relying on an exemption in Rule 15a-6 to operate an alternative trading system in the United States?*[18]

IV. Solicited Transactions

The SEC also proposed significant changes to the conditions under which a foreign broker-dealer may solicit a U.S. investor to buy or sell a security without registering with the SEC as a broker-dealer. Specifically, the Proposal would provide two new exemptions from the registration requirements for foreign broker-dealers engaging in solicited transactions with qualified investors: new paragraphs (a)(3)(iii)(A)(1) and (a)(3)(iii)(A)(2) (or so-called Exemption "(A)(1)" and "(A)(2)," respectively).

A. Conditions for Qualifying for the New Exemptions

In order to qualify for either Exemption (A)(1) or (A)(2) (collectively, the "Exemptions"), a foreign broker-dealer would be required to meet five conditions.

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14 *See* Rule 15a-6 Adopting Release.

15 Proposal, text at note 61.

16 *See id.* at pp. 23-24.

17 *See id.*, text at notes 62, 63.

18 Currently, alternative trading systems are required to be registered in the United States as broker-dealers.

(i) First, as is the case under the current Rule, the foreign broker-dealer would be required to provide the SEC with any documents or testimony relating to transactions effected pursuant to the Exemptions as the SEC might request.[19]

(ii) Second, the foreign broker-dealer must determine that its associated persons involved in transactions effected pursuant to the Exemptions are not subject to statutory disqualification under Section 3(a)(39) of the Exchange Act.[20]

The proposed Rule would shift the burden of making this determination, which currently resides with the U.S. broker-dealer intermediating transactions under the Rule, to the foreign broker-dealer.

(iii) Third, the foreign broker-dealer must have in its files an application questionnaire for each of its associated persons, as required by Exchange Act Rule 17a-3(a)(12). The foreign broker-dealer must agree to provide these files at the request of the SEC or of a U.S. registered broker or dealer that, as described further below, has taken responsibility for certain obligations of the foreign broker-dealer under the Exemptions. [21]

This is another shifting of obligations under the Proposal. Under the current Rule, the U.S. registered broker-dealer is required to maintain all books and records required by Rule 17a-3, including 17a-3(a)(12).

(iv) Fourth, the foreign broker-dealer must be regulated generally, and the specific activities in which the foreign broker-dealer engages with qualified investors must be regulated, by a foreign securities authority.[22]

This aspect of the proposed Rule is more restrictive than current Rule 15a-6.

(v) Fifth, the foreign broker-dealer must disclose to any qualified investors with which it interacts under the Exemptions that it is regulated by a foreign securities authority and not by the SEC. In addition, when taking advantage of Exemption (A)(1), the foreign broker-dealer must disclose that U.S. segregation requirements, bankruptcy protections, and protections under the Securities Investor Protection Act do not apply to any securities held by the foreign broker-dealer.[23]

As noted above, the SEC's proposed Rule would result in the shifting of a number of obligations between U.S. and foreign broker-dealers. Firms may need to examine and amend contracts governing 15a-6 relationships to address these changes.

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19 *See* Proposal at p. 51.

20 *See id.*

21 *See id.* at pp. 52-53. As under the current Rule, the foreign broker-dealer would be required to include any sanctions imposed by a foreign securities authority, exchange, or association.

22 *See* proposed Rule 15a-6(b)(2)(i), Proposal at p.118.

23 *See id.* at p. 35.

B. Exemption (A)(1): Direct Contacts with U.S. Investors

Under proposed Exemption (A)(1), a foreign broker-dealer would be permitted to effect all aspects of securities transactions with qualified investors and to maintain custody of qualified investors' funds and securities. Also, U.S. broker-dealers would *no longer* be required to (i) extend or arrange for the extension of credit, (ii) issue confirmations and account statements, (iii) receive, deliver, or safeguard funds and securities in compliance with Rule 15c3-3 under the Exchange Act (customer protection rule), or (iv) comply with Rule 15c3-1 under the Exchange Act (net capital rule) with respect to transactions under the Exemption.[24] Because U.S. broker-dealers would no longer be required to maintain accounts for customers effecting transactions under Exemption (A)(1), they may not have to comply with Rule 17a-8 for such accounts (which rule relates to financial recordkeeping and reporting of currency and foreign transactions).[25] As discussed below, however, this Exemption would only be available to regulated foreign broker-dealers that conduct a "foreign business."

1. *Role of the U.S. Registered Broker-Dealer*

For a foreign broker-dealer to take advantage of Exemption (A)(1), a registered U.S. broker-dealer would be required to maintain copies of all books and records, including statements and confirmations, relating to transactions effected under the Exemption. In a significant shift from the current Rule, the books and records could be maintained at the foreign broker-dealer in the manner and for the periods required by the foreign broker-dealer's local regulator. If the books and records are maintained at the foreign broker-dealer, the U.S. broker-dealer must make a reasonable determination that copies could be furnished to the SEC promptly. The SEC suggested that, in making this determination, the U.S. broker-dealer would need to consider any local legal limitations on the foreign broker-dealer's ability to provide information to the U.S. broker-dealer.[26]

The SEC also noted in the Proposal that, because under this Exemption the foreign broker-dealer would be permitted to effect all aspects of transactions, the U.S. registered broker-dealer would ordinarily not be responsible, with regard to such transactions, for compliance with the federal securities laws and SRO rules. As is currently the case, when foreign broker-dealers execute trades on a U.S. national securities exchange, through a U.S. ATS, or with a U.S. market maker or over-the-counter dealer, a U.S. broker-dealer would then be involved in effecting the transaction and required to comply with the federal securities laws and regulations, as well as SRO rules. In a somewhat confusing statement, the SEC notes that the U.S. regulatory regime would apply to all transactions in U.S. securities under Exemption (A)(1) "other than certain over-the-counter transactions that a foreign broker-dealer does not effect by or through a U.S. registered broker-dealer."[27] *It is unclear exactly what transactions this statement was intended to include or exclude, in particular, by the use of the word "certain."* This statement appears again in the SEC's discussion of Exemption (A)(2).

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24 *See id.* at p. 32.

25 *See id*. at p. 32.

26 *See id*. at p. 30.

27 *Id*. at pp. 31-32.

The SEC requested comment on a number of other aspects of proposed Exemption (A)(1), including whether:

- *The Proposal would raise anti–money laundering concerns;*
- *The foreign broker-dealer should be required to file an undertaking with the SEC that it will provide books and records at the request of the U.S. registered broker-dealer or the SEC, rather than requiring U.S. registered broker-dealers to make a reasonable determination that the foreign broker-dealer can promptly provide the documents requested by the SEC; and*
- *The "promptly" standard for production of books and records to the SEC is appropriate for foreign broker-dealers, given time-zone differences and geographical distances*.

With respect to last point, it also will be important for firms to obtain greater clarity from the SEC on the standard of reasonableness, in determining that local laws do not overly limit the ability of a foreign broker-dealer to provide the required books and records. For example, would a contractual representation by the foreign broker-dealer that no such limitations exist be sufficient? Would it be necessary to obtain an opinion from local counsel?

Also, it may be worthwhile for firms to seek clarification from the SEC on the interplay between Rule 17a-4(i) under the Exchange Act and the U.S. broker-dealers' recordkeeping obligations. Generally, SEC Rule 17a-4(i) requires a third-party vendor (who has been employed by a registered U.S. broker-dealer to maintain its books and records pursuant to SEC Rules 17a-3 and 17a-4) to file an undertaking similar to the one described above. It is not entirely clear, then, whether the SEC is suggesting that records maintained by the foreign broker-dealer would *not* be considered records of the registered U.S. broker-dealer for purposes of those books and records rules.

2. *The "Foreign Business" Limitation*

Proposed Exemption (A)(1) would only be available to foreign broker-dealers that, as defined by the Rule, conduct a "foreign business."[28] A broker-dealer conducts a "foreign business" if at least 85 percent of the aggregate absolute value of securities purchased or sold under either Exemption (A)(1) or (A)(2), or under the separate exemption for transactions with U.S. resident fiduciaries of non-U.S. persons (discussed below) are derived from transactions in foreign securities.[29] This calculation would be made on a rolling, two-year basis and the SEC noted that foreign business would include the foreign broker-dealer's business with qualified investors and with foreign resident clients.[30] This test may, in practice, be very complicated for firms to apply. We discuss the various elements of the test below.

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28 *See id*. at p. 36.

29 *See id*.

30 *See id*.

a. "Foreign Security"

"Foreign securities" would include debt securities and equity securities, as defined in 17 C.F.R. 230.405, of foreign private issuers, as defined in 17 C.F.R. 230.405,[31] debt securities of issuers organized or incorporated in the U.S. but distributed outside of the U.S. in accordance with Reg. S, and certain foreign government securities.[32] Derivative instruments that reference foreign securities would also be included in the definition, regardless of where they are issued. The SEC noted that derivatives that are not themselves securities would not be considered "foreign securities" and would therefore not be part of the 85 percent calculation. As such, "swap agreements," as defined by Section 206A of the Gramm-Leach-Bliley Act ("GLB") would not be included in the calculation.[33]

b. Valuation

In calculating the absolute value of all transactions for purposes of the foreign business test, foreign broker-dealers are instructed to use the premium paid for an option on a security, rather than the security's value. Securities futures would be valued at the price of the future times the number of shares to be delivered at the time the transaction is entered into. No guidance is given on calculating the absolute value of other types of transactions, such as repurchase agreements.

c. The 85 Percent Test

As noted above, foreign broker-dealers would be required under the Proposal to make the foreign business calculation on a rolling two-year basis. At the end of the first year in which a foreign broker-dealer relied upon Exemption (A)(1), it would be required to aggregate the "absolute value" of all securities purchased or sold for the preceding two year period to determine if it was eligible to continue relying on the Exemption.[34] Foreign broker-dealers would be given a 60-day grace period in which to continue using the Exemption after falling below the 85 percent threshold.[35]

While the Proposal is not entirely clear, it would apparently only require foreign broker-dealers to make the foreign business calculation annually. Firms would likely want to monitor their compliance with the 85 percent test more frequently. Firms will have to determine whether each of their clients or accounts is a U.S. client or account, necessitating the use of the Rule 15a-6 safe harbor. It will then be necessary to determine whether each transaction involves a security, as defined by the Rule, and, if so, determine a valuation for the security and whether the security is a foreign security, as defined by the Rule.

In proposing the 85 percent test, the SEC noted its understanding that foreign broker-dealers currently taking advantage of paragraph (a)(3) of the Rule do most of their business in foreign securities. The expectation is that foreign broker-dealers currently dealing with U.S. clients in reliance on paragraph (a)(3) would now use Exemption (A)(1) and that the limited trading in U.S. securities these foreign

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[31] SEC Rule 405 includes options within the definition of equity securities. Presumably, therefore, options on U.S. securities written by a foreign private issuer would be foreign securities under the proposed Rule. *See* Offshore Client Letter.

[32] The proposed Rule adopts the definition of "foreign private issuer" used in Rule 405 of Reg. C. 17 C.F.R. 230.405. Note that the SEC slightly mischaracterizes this definition in the Proposal. *See* Proposal at n. 92.

[33] *See* Proposal, at pp. 38-39.

[34] *See id*. at p. 39.

[35] *See id*. at p. 40.

broker-dealers would perform would either be as part of program trading or as an accommodation to customers.

d. Request for Comment

The SEC requested comment on a number of aspects of proposed Exemption (A)(1), including the following:

- *Is the proposed definition of foreign security appropriate? Should it include or exclude any particular types of securities? Will reference to the equity and debt securities of foreign private issuers affect listings of ADRs issued by depositaries against deposit of securities of foreign issuers on U.S. exchanges?*

- *Would the 85 percent foreign business test be workable and "relatively easy" to calculate? Should U.S. government securities be excluded from the calculation of business in U.S. securities?*

- *Is the 85 percent threshold appropriate to permit foreign broker-dealers to engage in transactions in U.S. securities as an accommodation to customers and as part of program trading?*

The SEC did not expressly request comment on the 60-day grace period in which firms would be allowed to continue using the Exemption after having fallen below the 85 percent threshold. In practice, firms may need to have customers give pre-authorization to move the customer's funds and securities to an affiliated U.S. broker-dealer in the event that the Exemption becomes unavailable. It may prove difficult to make arrangements to continue doing business with accounts using Exemption (A)(1) within 60 days.

C. Exemption (A)(2)

Unlike proposed Exemption (A)(1), proposed Exemption (A)(2) would not be limited to foreign broker-dealers conducting a foreign business. Also unlike Exemption (A)(1), the foreign broker-dealer relying on (A)(2) would not be able to maintain custody of qualified investor funds and securities relating to any resulting transactions. In that regard, U.S. broker-dealers still would be required to maintain custody of qualified investors' funds and securities and maintain books and records for transactions effected pursuant to the Exemption. They also presumably would be required to maintain these books and records in the United States, as required by SEC Rules 17a-3 and 17a-4, among others.[36] To be sure, the role of U.S. broker-dealers under Exemption (A)(2) would be similar to their role under current paragraph (a)(3) of Rule 15a-6, with one key difference: the U.S. intermediating broker-dealer would not be required to effect the transaction (regardless of the type of security involved).

D. Visits in the United States and Communications with U.S. Investors

Another significant change proposed by the SEC is to the rules governing contacts between associated persons of foreign broker-dealers and U.S. investors. The Proposal would eliminate cumbersome chaperoning requirements for communications relating to transactions under Exemptions (A)(1) and

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[36] *See Id*., at pp. 43-47. Under current guidance, foreign broker-dealers are permitted to directly settle and clear only transactions in foreign securities or U.S. Government securities. *See* Nine Firms Letter. Presumably, under the Proposal, foreign broker-dealers would be permitted to settle transactions in all U.S. securities.

(A)(2). Currently, foreign associated persons of foreign broker-dealers effecting transactions under the Exemptions will generally be required to conduct all securities activities from outside the United States. Under the Proposal, however, an associated person of a registered U.S. broker-dealer would not be required to participate in oral or electronic communications between foreign persons and qualified investors as part of a transaction effected under the Exemptions.

The SEC proposes to eliminate the requirement that an associated person of a registered U.S. broker-dealer participate in in-person visits between associated persons of foreign broker-dealers and U.S. investors. The SEC also proposed guidance that it would interpret "visit," so as to expand the number of days an associated person of a foreign broker-dealer could visit the U.S. from the current 30 days to 180 days.[37] What constitutes a "visit" would be a facts and circumstances determination including factors such as the "purpose, length, and frequency," of any stays in the U.S.[38]

The SEC requested comment on its proposed interpretation of "visit" and whether:

- *There should be a bright-line rule for what constitutes a visit; and*
- *180 days is an appropriate limit*.

V. Provision of Research Reports

Paragraph (a)(2) of Rule 15a-6 describes the conditions under which foreign broker-dealers are permitted to distribute research reports to certain U.S. investors without triggering the broker-dealer registration requirements. The only change the SEC proposes to this paragraph is to replace the reference to major U.S. institutional investors with a reference to qualified investors. Foreign broker-dealers would be permitted, without registration, to distribute research reports to qualified investors under the same conditions described in the current rule, *i.e.*: (i) that the reports do not recommend the use of the foreign broker-dealer to effect trades; (ii) the foreign broker-dealer does not initiate follow-up contacts with the qualified investors or otherwise induce or attempt to induce them to purchase or sell any securities; (iii) if the foreign broker-dealer has a relationship with a U.S. registered broker-dealer that satisfies the requirements of the rules regarding solicited trades, described above, any transactions in the securities described in the reports must be effected in accordance with those rules; and (iv) the foreign broker-dealer does not distribute research reports to U.S. persons with any express or implied understanding that the U.S. persons will send commissions to the foreign broker-dealer. If these conditions are met, the SEC will allow foreign broker-dealers to effect transactions in the securities covered by the research reports at the request of a qualified investor.

In explaining its determination to essentially retain this portion of the Rule, the SEC noted that it has "no knowledge of investor protection concerns having been raised with regard to foreign broker-dealers that operate in compliance with the current exemption."[39]

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37 *See* Proposal at p.50.

38 *Id*.

39 *Id*. at p. 26.

The SEC asked for comment on whether:

- *Any of the conditions of the exemption should be changed, given the expanded class of investors to which it will apply and the increased internationalization of securities markets; and*

- *The conditions should be more closely aligned with the requirements of the rules governing solicited trades and, if so, how*.

VI. Transactions with Specific Counterparties and Customers

The SEC's Proposal would leave intact the current exemptions under paragraph (a)(4) of the Rule relating to transactions with specific counterparties and customers (*e.g.*, transactions with banks or registered broker-dealers).[40] Importantly, however, the Proposal would add one new category to the list of exemptions under paragraph (a)(4), adopting in part the position of the SEC's so-called "Offshore Client" no-action letter of 1996.[41] Under the Proposal, transactions between a foreign broker-dealer and a U.S. resident fiduciary of an account for "foreign resident clients" would be exempt from the broker-dealer registration requirements.[42]

The definition of "foreign resident client" would track closely the definition of "offshore client" used in the 1996 no-action letter. Under the Proposal, a foreign resident client would include: (i) any entity not organized or incorporated under the laws of the United States and not engaged in a trade or business in the United States for federal income tax purposes; (ii) any natural person not a U.S. resident for federal income tax purposes; and (iii) any entity not organized or incorporated under the laws of the United States 85 percent or more of whose outstanding voting securities are beneficially owned by persons in paragraphs (i) and (ii).[43] Foreign broker-dealers taking advantage of this exemption would be required to obtain a written representation from the U.S. resident fiduciary that it manages the account in a fiduciary capacity for a foreign resident client.[44]

Notably, this new exemption would not be limited to transactions in foreign or U.S. government securities. Nevertheless, it appears to scale back the flexibility that non-U.S. brokers have under the current regulatory regime, in that: (i) the exemption only would be available to broker-dealers who meet the 85 percent "foreign business test" discussed above at Section IV(A)(2); and (ii) it would not apply explicitly to a U.S. citizen residing in a foreign country, provided that the citizen (a) has $500,000 or more under management of the U.S. resident fiduciary, or (b) has a net worth (together with his or her spouse) in excess of $1,000,000.[45]

VII. Familiarization with Foreign Options Exchanges

Finally, the SEC proposed to add a new paragraph (a)(5) to the Rule, which would create an exemption from registration for certain activities of foreign options exchanges, their representatives, and foreign

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40 The SEC noted that it has "no knowledge of investor protection concerns being raised" with regard to the current application of these exemptions. *See id*. at p. 56.

41 *See* Offshore Client Letter.

42 *See* Proposal at p. 56.

43 *See id*. at p. 118.

44 *See id*. at pp. 58-59.

45 *See* Offshore Client Letter.

broker-dealers that are members of such foreign options exchanges. Under the Proposal, representatives of a foreign options exchange may communicate with persons whom they reasonably believe to be qualified investors—without being deemed to have solicited that investor—regarding the exchange, the options traded on the exchange, and the exchange's "OTC options processing service."[46] A foreign options exchange representative also may provide persons reasonably believed to be qualified investors with a disclosure document discussing the exchange, the options traded on the exchange, and relevant differences between such options and U.S. standardized options.[47] Upon the request of the investor, the representative may provide a list of participants taking orders on the options exchange, as well as any U.S. registered broker-dealer affiliates of such participants.[48] Further, foreign broker-dealers would be permitted to engage in certain activities related to foreign options exchanges without triggering the broker-dealer registration requirements, such as making a foreign options exchange's OTC options processing service available to qualified investors.

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46 "OTC options processing service" would be defined as "a mechanism for submitting an options contract on a foreign security that has been negotiated and completed in an over-the-counter transaction to a foreign options exchange so that the foreign options exchange may replace that contract with an equivalent standardized options contract that is listed on the foreign options exchange and that has the same terms and conditions as the over-the-counter options." *See* Proposed Rule 15a-6(b)(6), Proposal at p. 119.

47 *See id*. at p. 62.

48 *See id*. at pp. 62-63. They also may provide investors, on an unsolicited basis, with a disclosure document regarding the exchange and the options listed on the exchange.