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SEC GIVES GUIDANCE TO NON-U.S. BROKER-DEALERS THROUGH RULE 15A-6 FAQs

On March 21, 2013, the staff of the U.S. Securities and Exchange Commission's Division of Trading and Markets ("SEC Staff") released answers to frequently asked questions ("FAQs")[1] concerning Rule 15a-6 under the U.S. Securities Exchange Act of 1934. The Rule permits non-U.S. broker-dealers ("Foreign BDs")[2] to conduct certain activities vis-à-vis U.S. investors without having to register as broker-dealers with the SEC. The FAQs help Foreign BDs by clarifying how certain activities should be treated for purposes of the Rule. This *Commentary* summarizes certain key FAQs of interest to Foreign BDs engaging in transactions with persons in the U.S., either with or without Rule 15a-6 "chaperoning" arrangements[3] in place.

In brief, the FAQs address:

- Activities by Foreign BDs that the SEC Staff would not view as "soliciting" transactions (which may include the administration of non-U.S. company employee share plans);
- The ability of Foreign BDs with chaperoning arrangements in place to provide research reports to major U.S. institutional investors ("MUSIIs") without the involvement of chaperones;
- The ability of Foreign BDs with chaperoning arrangements in place to send confirms and account statements directly to U.S. counterparties;
- Situations in which foreign persons are deemed only temporarily present in the U.S. for purposes of the Rule; and
- The ability of Foreign BDs without SEC-registered broker-dealer affiliates to take advantage of more liberal SEC interpretations of Rule 15a-6 previously set out in the SEC's "Seven Firms"[4] and "Nine Firms"[5] no-action letters.

Prior to the release of the FAQs, there was uncertainty as to how the SEC Staff would view some of these activities for purposes of the Rule. The FAQs should help Foreign BDs determine the extent to which they may contact U.S. investors without U.S. broker-dealer registration by providing greater clarity as to the SEC Staff's current interpretation of some of the provisions of the Rule.

RULE 15A-6

Rule 15a-6 contains four conditional exemptions that Foreign BDs may use to avoid the requirement to register with the SEC as a broker-dealer. Registration generally is otherwise triggered by soliciting and engaging in securities transactions with persons in the U.S. These exemptions provide a tiered system of permissible nondirect or direct contacts that could lead to securities transactions and that may be engaged in by unregistered Foreign BDs. The exemptions are based on the sophistication of the investor and the reasonableness of investor expectations that they will be afforded the protections of U.S. broker-dealer registration.

The Rule permits Foreign BDs to do the following without SEC broker-dealer registration:

- Effect unsolicited transactions for any investors;[6]
- Provide research reports to MUSIIs and (subject to no other solicitation by the Foreign BD of the MUSII) effect resulting transactions;[7]
- Solicit and effect transactions with U.S. institutional investors or MUSIIs through chaperoning arrangements with SEC-registered broker-dealers;[8] and
- Solicit and effect transactions (even outside chaperoning arrangements) with SEC registered broker-dealers, U.S. regulated banks acting as brokers or dealers, certain international organizations, foreign persons temporarily in the U.S., U.S. citizens resident abroad, and foreign branches and agencies of U.S. persons.[9]

Rule 15a-6 is considered a great success in enabling Foreign BDs, particularly those with chaperoning arrangements, to access U.S. investors. However, there also have been problems with the Rule and questions as to its likely interpretation by the SEC Staff, which in some cases limited its usefulness.[10]

PRIOR INTERPRETIVE POSITIONS

The SEC Staff has previously taken some positions to facilitate the usefulness of the Rule in light of practical problems experienced. For example, the Seven Firms letter enabled Foreign BDs to solicit and effect transactions in "foreign securities"[11] with non-U.S. client accounts held by U.S. fiduciaries, such as investment advisers, outside chaperoning arrangements.

The Nine Firms letter provided significant relief by expanding the MUSII definition to include all entities (including corporations and partnerships) owning or controlling more than $100 million in aggregate financial assets and investment advisers (even those not registered with the SEC) with more than $100 million of financial assets under management. The Nine Firms letter also permitted Foreign BDs to have some unchaperoned oral communications with U.S institutional investors and some unchaperoned visits to MUSIIs, and to transfer funds or securities directly to a U.S. institutional investor or MUSII in transactions involving foreign securities, although acting as a custodian of U.S. investor funds or securities is not permitted.

More recently, the SEC Staff has permitted companies with more than $100 million in total assets, rather than aggregate financial assets, to be treated as MUSIIs by certain Foreign BDs in the context of some of their M&A advisory activities.[12]

THE NEW FAQs

The FAQs continue the trend of the SEC Staff allowing liberal use of Rule 15a-6 by Foreign BDs.[13]

The following summarizes certain key points covered by the FAQs of interest to Foreign BDs:[14]

Unsolicited Transactions.[15] The SEC Staff does not view providing U.S. investors with confirmations and statements (or documents required to be sent under non-U.S. law, such as prospectuses, proxy statements, or privacy notices) as a solicitation. The SEC Staff also does not view the administration of a non-U.S. employee share option or other benefit plan for a non-U.S. issuer as a solicitation of the issuer's U.S. subsidiaries or the plan's U.S. employee participants, as long as the Foreign BD deals only with non-U.S. personnel in administering the plan. The Foreign BD must limit its activities with respect to U.S. employee participants to facilitating the transfer, sale, or disposition of securities (which may include those

issued under sponsored American Depositary Receipt programs) and sending required plan documents, statements, confirmations, privacy notices, prospectuses, proxy statements, or other legally required documents. The SEC Staff further does not view a single securities transaction effected by a Foreign BD for a U.S. investor in accordance with Rule 15a-6(a)(1) as precluding further unsolicited securities transactions for the same investor, absent any other solicitation.

The SEC has historically taken a broad view as to what might constitute solicitation, which the FAQs confirm continues to be the case, and this has often led to a reluctance on the part of Foreign BDs to rely on the unsolicited transaction exemption. The FAQs provide very helpful additional color as to activities that can be engaged in without concern.

A Foreign BD seeking to rely on the unsolicited transaction exemption should note that it may not provide a U.S. investor with any document that includes advertising or other material intended to induce either securities transactions or transactional business for the Foreign BD or its affiliates. Careful monitoring of the content of all materials sent to U.S. investors will be required, as will precautions so that internet and other public communications will not be viewed as solicitations directed to U.S. investors.

Foreign BDs should also be aware that the SEC Staff stated in the FAQs its views that (i) if a Foreign BD regularly effects transactions directly with or for a U.S. investor, the investor might reasonably expect the protections of U.S. broker-dealer registration, and (ii) frequent or a significant number of transactions between a Foreign BD and a U.S. investor may be indicative of solicitation. Foreign BDs should continue to be cautious and not place too much reliance on the unsolicited transaction exemption, particularly in respect of less sophisticated investors, including non-MUSIIs, and any unsolicited investor that begins to trade frequently.

Research Reports.[16] Foreign BDs may provide research reports (i) to MUSIIs, directly or indirectly, under Rule 15a-6(a)(2), or (ii) to all U.S. investors, indirectly through SEC-registered broker-dealers that take responsibility for the content of the research report, pursuant to Rule 15a-6(a)(3) chaperoning arrangements.

The FAQs confirm that Foreign BDs with Rule 15a-6(a)(3) chaperoning arrangements in place may still provide research reports directly to MUSIIs under Rule 15a-6(a)(2). Chaperones do not have any obligations with respect to research reports where the chaperone is not involved with the distribution of the report, although they must retain records of the research reports if provided with copies.

Foreign BDs with chaperoning arrangements in place should keep in mind that any transactions in securities discussed in research reports distributed in accordance with Rule 15a-6(a)(2) would still need to be effected through chaperones in accordance with Rule 15a-6(a)(3).

Confirmations and Statements.[17] The FAQs confirm that Foreign BDs with chaperoning arrangements are permitted to send confirmations and statements directly to U.S. counterparties if required by foreign law or their internal compliance policies. Chaperoning broker-dealers still must ensure that confirmations and statements complying with U.S. requirements and identifying the chaperoning broker-dealer and its role are sent to U.S. investors on their behalf.

A Foreign BD and its U.S. chaperone will need to put in place the appropriate compliance procedures for the chaperone to comply with its obligations if confirmations and statements sent by the Foreign BD will satisfy these requirements. If the confirmations and statements sent by the Foreign BD do not satisfy these requirements, the chaperone must send separate confirmations and statements meeting the requirements.

Foreign Persons Temporarily Present in the U.S.[18] The FAQs further clarify the extent to which a foreign person would be considered only temporarily present in the United States, including those that actually are residing in the United States for employment or education on a finite basis. The FAQs make clear that Foreign BDs may continue to do business with persons with whom they had preexisting relationships when such persons are in the United States, provided those persons are neither U.S. citizens nor permanent residents (i.e., “green card” holders).

When dealing with customers who have relocated to the United States, Foreign BDs should ascertain the customers' U.S. citizenship or residency status. Entering into transactions with U.S. citizen or permanent resident customers previously resident abroad who have returned to the U.S., particularly if other than for a short business trip or holiday, could be problematic.

Seven Firms and Nine Firm Letters.[19] The FAQs confirm that Foreign BDs without SEC-registered broker-dealer affiliates may also rely on the positions set out in the Seven Firms and Nine Firms letters described above. These positions are very important to facilitate the usefulness of Rule 15a-6. They greatly expand the scope of permissible activities for Foreign BDs vis-à-vis certain U.S. counterparties.

CONCLUSION

The FAQs address a number of areas that have previously been unclear and should assist Foreign BDs wishing to take advantage of the Rule's various exemptions. Compliance with Rule 15a-6 is often a very fact-specific determination, and questions will no doubt continue to arise. The willingness of the SEC Staff to provide guidance through the FAQs and similar guidance in the future is and will continue to be a positive development in facilitating the availability of the Rule 15a-6 exemptions for their intended purposes.

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ENDNOTES

1 The FAQs are available at: http://www.sec.gov/divisions/marketreg/faq-15a-6-foreign-bd.htm. The FAQs may be updated, modified or withdrawn in the future.

2 Foreign BDs eligible to rely on Rule 15a-6 are non-U.S. resident legal or natural persons that are not offices or branches of (or natural persons associated with) brokers or dealers registered with the SEC and whose securities activities, if conducted in the United States, would fall within the Exchange Act's definitions of "broker" or "dealer." Under these definitions, brokers and dealers are persons engaged in the business of effecting transactions in securities for the account of others or for their own account, respectively.

3 Under the Rule, Foreign BDs with chaperoning arrangements in place are permitted greater contacts and transactions with U.S. investors than those without. A chaperoning arrangement requires a U.S. registered broker-dealer to take responsibility for conducting and monitoring certain activities in connection with a Foreign BD's U.S. investor contacts and transactions.

4 *See* "Letter re: Transactions in Foreign Securities by Foreign Brokers or Dealers with Accounts of Certain Foreign Persons Managed or Advised by U.S. Resident Fiduciaries" (January 30, 1996), which was granted at the request of the Foreign BD affiliates of seven SEC registered broker-dealers.

5 *See* "Letter re: Securities Activities of U.S.-Affiliated Foreign Dealers" (April 9, 1997), *available at* http://www.sec.gov/divisions/marketreg/mr-noaction/cleary040997.pdf, which was granted at the request of the Foreign BD affiliates of nine SEC registered broker-dealers.

6 *See* Rule 15a-6(a)(1).

7 *See* Rule 15a-6(a)(2).

8 *See* Rule 15a-6(a)(3).

9 *See* Rule 15a-6(a)(4).

10 *See* "SEC Charges Four India-Based Brokerage Firms with Violating U.S. Registration Requirements," *available at* http://www.sec.gov/news/press/2012/2012-241.htm, regarding recent administrative actions against Foreign BDs.

11 For purposes of the Seven Firms and Nine Firms letters, "foreign securities" are (i) securities issued by issuers not organized under U.S. law (including depositary receipts issued by U.S. banks that were initially offered and sold outside the U.S. under Regulation S) where the transaction is not effected on a U.S. exchange or through the Nasdaq system, (ii) debt securities (including convertibles) issued by issuers organized under U.S. law in connection with a non-U.S. distribution (but not if part of a "global offering" where the U.S. portion of the distribution was registered with the SEC), and (iii) OTC derivatives on securities described in (i) or (ii) above.

12 *See* "Letter re: Merger and Acquisition Activities of Foreign Firms in Reliance on Rule 15a-6" (July 12, 2012), *available at* http://www.sec.gov/divisions/marketreg/mr-noaction/2012/ernstyoung071212-15a6.pdf.

13 Indeed, in 2008 the SEC proposed a number of amendments to update and expand the scope of the Rule 15a-6 exemptions to reflect the increasing internationalization in securities markets and advancements in technology and communication services, although these amendments have not been adopted to date. *See* SEC Release No. 34-58047, "Exemption of Certain Foreign Brokers or Dealers" (June 27, 2008), *available at* http://www.sec.gov/rules/proposed/2008/34-58047.pdf.

14 The FAQs also (i) confirm that the SEC Staff's expanded view of investors eligible for MUSII treatment set out in the Nine Firms letter applies to all provisions of Rule 15a-6, and (ii) provide guidance as to net and other regulatory capital and record-keeping requirements for SEC-registered broker-dealers acting as Rule 15a-6 chaperones.

15 *See* FAQs 2, 3, and 9.

16 *See* FAQ 5.

17 *See* FAQ 4.

18 *See* FAQ 1.

19 *See* FAQs 6 and 8.