



JONES DAY
COMMENTARY

SEC PROPOSES REVISIONS TO RULE 15A-6 TO IMPROVE REGULATION OF FOREIGN BROKER-DEALERS

On June 23, 2008, the Securities and Exchange Commission (“SEC”) proposed revisions to Rule 15a-6 in order to expand the scope of activities that may be undertaken in the U.S. by foreign broker-dealers without registering under the Securities Exchange Act of 1934. Most importantly, the proposed revisions would expand the category of U.S. investors that foreign broker-dealers may contact for the purpose of providing research reports and soliciting securities transactions.¹ These proposed rule changes have the potential to increase U.S. investor access to securities of non-U.S. issuers and reduce related transaction execution costs.

CURRENT RULE

The current Rule 15a-6 provides conditional exemptions from broker-dealer registration for foreign broker-dealers that engage in, among others, the following activities involving specific categories of U.S. investors:

- indirect contacts by foreign broker-dealers with U.S. investors through execution of unsolicited securities transactions and providing research reports; and
- direct contacts, involving solicitation of transactions through a registered broker-dealer intermediary with or for U.S. institutional investors, and without this intermediary with or for certain entities such as registered broker-dealers and banks acting in a broker or dealer capacity.

OVERVIEW OF PROPOSED RULE

The SEC is proposing a number of changes to Rule 15a-6, including those designed to:

- provide interpretive guidance that the SEC would not consider solicitation to have occurred if a foreign broker-dealer distributed in the U.S. quotations through third-party systems operated by foreign marketplaces or by private vendors that distribute these quotations primarily in foreign countries;²

¹ Comments on these proposals should be received by the SEC on or before September 8, 2008.

² The SEC cautioned that it would have reservations about certain specialized quotation systems, such as those that disseminated quotes only for large block trades, as these may constitute a more powerful inducement to effect trades.

- expand the category of U.S. investors to encompass “qualified investors” to which a foreign broker-dealer could provide research reports and solicit trades;
- provide for greater flexibility in direct communications and transactions between U.S. investors that are “qualified investors” and foreign broker-dealers;
- allow for meetings and oral and written communications between foreign broker-dealers and “qualified investors” without any “chaperoning” by a U.S. registered broker-dealer; and
- allow for greater information flow and the execution of transactions between foreign options exchanges and their agents and “qualified investors.”

INTERPRETIVE GUIDANCE REGARDING THIRD-PARTY QUOTATION SYSTEMS

Under the proposed interpretation, U.S. distribution of foreign broker-dealer quotations by a third-party system (which did not allow securities transactions to be executed through the system between the foreign broker-dealer and the persons in the U.S.) would not be viewed as a form of solicitation, in the absence of other contacts with U.S. investors initiated by the third-party system or the foreign broker-dealer.

QUALIFIED INVESTORS

The proposed rule would expand the range of U.S. investors with which a foreign broker-dealer could interact by replacing the categories of “major U.S. institutional investor” and “U.S. institutional investor” under the current rule with the category of “qualified investor.” The use of qualified investor under the proposed rule would serve to expand the foreign broker-dealer exemptions by including, among others, entities (e.g., investment companies, partnerships, and companies) as well as natural persons that own or invest, on a discretionary basis, \$25 million or more in investments.

While the use of the new qualified investor category would generally expand the scope of U.S. investors with which foreign broker-dealers could interact, in some instances, it would exclude persons that are currently included in the definition of U.S. institutional investor or major U.S. institutional investor. A few examples are as follows:

- Qualified investor includes employee benefit plans in which investment decisions are made by certain plan

fiduciaries, whereas the definition of U.S. institutional investor does not require a fiduciary to make investment decisions and only includes plans with \$5 million or more in assets.

- Qualified investor applies to trusts whose purchases are directed by certain entities, whereas the definition of U.S. institutional investor does not impose that limitation; instead, it applies to certain trusts with \$5 million or more in assets.
- While both qualified investor and U.S. institutional investor encompass business development companies, the definition of U.S. institutional investor extends to private business development companies.

PROVISION OF RESEARCH REPORTS

As discussed above, although foreign broker-dealers may distribute research reports, the rule’s current conditions relating to recommendations of the foreign broker-dealer, contacts between U.S. investors and the foreign broker-dealer, and the execution of trades for the securities referenced in the research report would continue to apply.

SOLICITED TRADING EXEMPTIONS

The proposed rule is designed to reduce the role to be played by the U.S. registered broker-dealer intermediary and increase the role and responsibilities of the foreign broker-dealer in transactions between qualified investors and foreign broker-dealers. The two proposed methods require that the foreign broker-dealer be regulated by a foreign securities authority for conducting securities activities and disclose to qualified investors that the foreign broker-dealer is subject to such regulation and not that of the SEC. The most significant difference between the two proposed methods is that one (“Exemption (A)(1)”) allows the foreign broker-dealer to custody funds and securities of U.S. investors.

Proposed Exemption (A)(1). The first proposed exemption, Exemption (A)(1), would for the first time allow foreign broker-dealers to provide full-service brokering services to certain U.S. investors and increase responsibilities of foreign broker-dealers, thereby lessening the custodial role played by U.S. registered broker-dealers as follows:

- A U.S. registered broker-dealer would be allowed to maintain copies of all books and records through the

foreign broker-dealer in the form, manner, and for the periods prescribed by the foreign securities authority regulating the foreign broker-dealer.

- The intermediating U.S. registered broker-dealer would no longer be required to effect all aspects of the transaction and thus, if it is not involved in effecting the transaction, would no longer be required to comply with the provisions of federal securities law and SRO rules applicable to the intermediary effecting a transaction in securities.
- The intermediating U.S. registered broker-dealer would no longer be required, among other items, to maintain accounts for customers of foreign broker-dealers or receive, deliver, and safeguard their funds and securities.
- The foreign broker-dealer would be required to disclose that U.S. funds and assets segregation requirements, U.S. bankruptcy protections, and protections under the Securities Investor Protection Act will not apply to any funds and securities of the qualified investor held by the foreign broker-dealer.

Exemption (A)(1) would be available only for foreign broker-dealers that conduct a “foreign business.” The proposed rule defines “foreign business” to mean the business of foreign brokers or dealers with qualified investors and foreign resident clients where at least 85 percent of the aggregate value of the securities purchased or sold in certain solicited transactions under the rule by the foreign broker or dealer, calculated on a rolling two-year basis, is derived from transactions in foreign securities.³

Proposed Exemption (A)(2). The second exemption proposed under the new rule (“Exemption (A)(2)”) would allow a foreign broker-dealer to effect transactions for qualified investors that custody their funds and securities with a U.S. registered broker-dealer. The current rule requires an intermediating U.S. registered broker-dealer to effect such transaction. In addition, under this exemption, the U.S. registered broker-dealer

would be responsible for maintaining books and records relating to any transactions and receiving, delivering, and safeguarding funds and securities in connection with those transactions.

Sales Activities. Both proposed Exemption (A)(1) and proposed Exemption (A)(2) would eliminate the requirements for foreign associated persons⁴ of the foreign broker-dealer to be accompanied by an associated person of a U.S. registered broker-dealer during in-person visits with U.S. investors. The proposed rule also would eliminate the current requirement for an associated person of a U.S. registered broker-dealer to participate in communications between foreign associated persons and U.S. investors, whether oral or electronic.

Establishment of Qualification Standards. Foreign broker-dealers intending to rely on the proposed rule to solicit trading would need to meet certain qualification requirements. Under the proposed rule (as under the current rule), the foreign broker-dealer would be required to provide the SEC information or documents related to the foreign broker-dealer’s activities in inducing or attempting to induce securities transactions by qualified investors. However, under the proposed rule, certain responsibilities in the establishment of these qualification standards are shifted from the U.S. registered broker-dealer to the foreign broker-dealer. For example, the foreign broker-dealer would be required to determine that its associated persons that effect transactions with qualified investors are not subject to U.S. statutory disqualifications or substantially equivalent foreign disciplinary actions. In addition, the foreign broker-dealer would be required to obtain and make available information relating to the solicitation of trades by each foreign associated person as well as provide a written consent to service of process for any civil action brought by or proceeding before the SEC or a self-regulatory organization.

³ Under the proposed rule, “foreign securities” would include:

- a debt or equity security of a foreign private issuer;
- a debt security issued by an issuer organized or incorporated in the United States in connection with a distribution conducted solely outside the United States pursuant to Regulation S;
- a security that is a note, bond, debenture, or evidence of indebtedness issued or guaranteed by a foreign government that is eligible to be registered with the SEC (under Schedule B of the Securities Act); and
- a derivative instrument on a security described above.

⁴ A “foreign associated person” is a natural person domiciled outside the U.S. who is associated with the foreign broker-dealer and participates in the solicitation of a qualified investor under the rule.

FOREIGN OPTIONS EXCHANGES

The proposed rule also provides for certain changes that are designed to familiarize certain U.S. persons and entities with the existence and operations of foreign options exchanges as well as with the options on foreign securities traded on such exchanges. In particular, the proposed rule would allow:

- the representative of a foreign options exchange to communicate with persons that he or she reasonably believes are qualified investors regarding the foreign options exchange, the options on foreign securities traded there, and the foreign options exchange's OTC options processing service and logistics, if any;
- a foreign broker-dealer to provide qualified investors, in response to an otherwise unsolicited inquiry, with a disclosure document that provides an overview of the foreign options exchange and the options on foreign securities traded on that exchange; and
- a foreign broker-dealer that is a member of a foreign options exchange to effect transactions in options on foreign securities listed on that exchange for a qualified investor that has not otherwise been solicited by the foreign broker-dealer.

POTENTIAL IMPLICATIONS OF PROPOSED RULE

The proposed rule could have a number of important benefits to U.S. investors, U.S. registered broker-dealers, foreign broker-dealers, and the markets generally. Potential benefits include:

- A broader category of U.S. investors could have greater access to foreign broker-dealers and foreign markets by expanding and streamlining the conditions under which a foreign broker-dealer could operate without triggering the broker-dealer registration requirements of the Exchange Act; and
- U.S. registered broker-dealers and foreign broker-dealers could have greater flexibility in how they conduct business in the context of foreign broker-dealer contacts with U.S. investors with potentially lower costs.

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