

SEC Proposes Major Revisions to Rule 15a-6

June 30, 2008

What This Means

The Securities and Exchange Commission (SEC) recently proposed substantial amendments to Rule 15a-6 under the Securities Exchange Act of 1934 (Exchange Act), which provides conditional exemptions from broker-dealer registration for foreign entities involved in certain activities involving certain U.S. investors. The proposed amendments to Rule 15a-6 would expand the scope of certain of those exemptions, and would ease or eliminate some of existing restrictions on interactions between foreign broker-dealers and U.S. customers. Comments on the proposal are due to the SEC 60 days after the proposal is published in the Federal Register, which should be during this week (June 30).

Discussion and Analysis

The SEC addresses a number of specific areas under Rule 15a-6, including: (1) persons who can be contacted by a foreign broker-dealer; (2) dissemination of quotes by foreign broker-dealers; (3) distribution of research reports by foreign broker-dealers; (4) execution of trades; (5) counterparties and specific customers; and (6) providing information to U.S. customers regarding foreign options exchanges.

In addition, the SEC has proposed to extend the formal exemptive relief under Rule 15a-6 to reporting and other applicable requirements of the Exchange Act and the rules thereunder, except those under Exchange Act Sections 15(b)(4) and 15(b)(6), which relate to misconduct by broker-dealers and their associated persons. Currently, this relief is covered by an SEC staff no-action position.

Interaction between Foreign Broker-Dealers and “Qualified Investors”

- Under the proposed rule, foreign broker-dealers would be able to interact with “qualified investors,” as defined in Section 3(a)(54) of the Exchange Act, which includes institutional investors or natural persons who own or invest on a discretionary basis at least \$25 million in assets. Currently, Rule 15a-6 restricts foreign broker-dealers to interacting with those U.S. non-institutional investors with at least \$100 million in assets.

Solicitation of Trades with Respect to Quotation Systems

- The SEC’s current view on the use of quotation systems is that a solicitation has not occurred for purposes of Rule 15a-6 where there is a U.S. distribution of foreign broker-dealers’ quotations by third-party systems, such as systems operated by foreign marketplaces or by private vendors, that distribute the quotations primarily in foreign countries and that do not allow securities transactions to be executed between foreign broker-dealers and persons in the United States.
- Under the proposal, the SEC would eliminate the condition that the quotations be distributed primarily in foreign countries, so that U.S. distribution of foreign broker-dealers’ quotations by a third-party system that does not provide execution capability would not be considered as a form of solicitation in the absence of other contacts between the foreign broker-dealer and U.S. investors.

Distribution of Research Reports by Foreign Broker-Dealers

- The SEC proposed to allow foreign broker-dealers to distribute research reports to, and effect transactions in the securities described in the research reports with, “qualified investors,” as described above, rather than restricting distribution to institutional investors and natural persons with \$100 million or more in assets. The remainder of the current restrictions on distribution of research reports by foreign broker-dealers (e.g., not recommending use of the foreign broker-dealer to effect transactions) would remain in effect under the proposed rule.

Solicitation of Transactions by Foreign Broker-Dealers

- Under the proposal, many of the requirements for a foreign broker to solicit purchases or sales from U.S. investors would be eliminated. For example, the proposal would eliminate the current “chaperoning” requirement under Rule 15a-6, although the proposal would maintain some restrictions on direct contact between a foreign broker-dealer and a U.S. investor, including that a foreign associated person could not stay in the United States over 180 days a year.
- In addition, the foreign broker-dealer would be required to meet qualification standards. The proposal would retain the current requirement, under Rule 15a-5b, that the foreign broker-dealer provide the SEC, upon request or pursuant to agreement between the SEC or the United States and any foreign securities authority, information or documents related to the foreign broker-dealer’s activities in inducing or attempting to induce securities transactions by qualified investors. In addition, Rule 15a-6 would require the foreign broker-dealer to determine that its associated persons that effect transactions with qualified investors are not subject to a statutory disqualification under Section 3(a)(39) of the Exchange Act.
- Overall, the current requirements under Rule 15a-6 would be replaced with two exemptions, one for broker-dealers that conduct a “foreign business,” and another exemption that could be used by all foreign broker-dealers.
 - **Exemption for Foreign Broker-Dealers Conducting a Foreign Business (Referred to as “Exemption (A)(1)” in the SEC Release).** Under Exemption (A)(1), a foreign broker-dealer would be able to effect transactions and custody funds and securities for qualified investors subject to the following conditions:
 - A U.S. registered broker-dealer would have to maintain the books and records for the transactions. The requirement also would be considered met if books and records generated by the foreign broker-dealer were maintained by the foreign broker-dealer, as long as the U.S. broker-dealer was able to obtain and provide those records to the SEC on request.
 - The foreign broker-dealer would have to be regulated by a “foreign securities authority,” which is defined under the Exchange Act to be a foreign government, governmental body, or regulator given authority by a foreign government to enforce that country’s securities laws.
 - The foreign broker-dealer would be required to disclose that it is not regulated by the SEC and that protections such as SIPC protection do not apply.
 - To satisfy the “foreign business” requirement, at least 85% of the aggregate value of the securities bought or sold by U.S. investors or foreign residents in the U.S. from the foreign broker-dealer must be in foreign securities. This value would be calculated on a two-year rolling basis.
 - **Foreign Broker-Dealers using a U.S. Custodian (Referred to as “Exemption (A)(2)” in the SEC Release).** Exemption (A)(2) would allow foreign broker-dealers to effect transactions for qualified investors that custody their funds and securities with a U.S. registered broker subject to the following conditions:
 - The U.S. registered broker-dealer would have to maintain the books and records for any transaction effected by the foreign broker-dealer.

- The U.S. registered broker-dealer would be required to receive, deliver, and safeguard funds and securities for the transactions effected by the foreign broker-dealer in compliance with the SEC's customer protection rule.
- The foreign broker-dealer would have to be regulated by a foreign securities authority.
- The foreign broker-dealer would have to disclose that it is not regulated by the SEC.
- Under both of the proposed exemptions, a U.S. registered broker-dealer would have to be involved in effecting any transactions on a U.S. securities exchange or alternative trading system, or with a U.S. market maker or over-the-counter dealer.
- In addition, foreign broker-dealers relying on either exemption would have to meet certain qualification requirements and would be required to determine that its associated persons that effect transactions with a qualified investor are not subject to any statutory disqualification.

Additional Proposals

- **Transactions Involving Foreign Resident Clients.** The SEC's proposal would allow foreign broker-dealers solicit and effect transactions involving foreign resident clients. A foreign resident client would be defined as: (1) an entity not organized in the U.S. or engaged in a trade or business under U.S. tax laws; (2) a natural person who is not a U.S. resident under U.S. tax laws; or (3) an entity not organized in the U.S. and is at least 85% owned by an entity or person that meets either of the first two definitions of a foreign resident client.
- **Providing Information Regarding Foreign Options Exchanges.** Under the proposal, a foreign broker-dealer would be permitted to effect transactions involving options on foreign securities on the foreign options exchange of which it is a member for a "qualified investor" if the foreign broker-dealer did not solicit the investor. The proposal would also permit certain activities by a foreign options exchange representative or foreign office, which would include providing qualified investors with a disclosure document that describes the foreign options exchange and, upon request by the investor, providing a list of participants that can take orders for that exchange.

To view the SEC's proposal, please visit: <http://www.sec.gov/rules/proposed/2008/34-58047.pdf>.

How Morgan Lewis Can Help

Morgan Lewis's Broker-Dealer and Capital Markets Regulation Practices regularly advise clients on the application of Rule 15a-6 and assist clients with structuring arrangements under the rule. If you have any questions concerning these important legal developments, please contact any of the following Morgan Lewis attorneys:

New York

Joshua Blackman	212.309.7131	jblackman@morganlewis.com
Jennifer L. Klass	212.309.7105	jklass@morganlewis.com
Robert C. Mendelson	212.309.6303	rmendelson@morganlewis.com

Washington, D.C.

John V. Ayanian	202.739.5946	jayanian@morganlewis.com
Mark D. Fitterman	202.739.5019	mfitterman@morganlewis.com
Steven W. Stone	202.739.5453	sstone@morganlewis.com

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