



Regulatory Update – SEC Proposes Changes to Rule 15a-6

Distributed by:

The Securities and Futures Regulation Group

July 2008

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After many years of waiting, broker-dealers may finally get some relief from the current strictures of Rule 15a-6 under the Securities Exchange Act of 1934 ("Exchange Act"). On June 27, 2008, the Securities and Exchange Commission ("SEC") voted to propose extensive revisions to the safe harbor from registration for foreign broker-dealers conducting limited business within the United States.¹ For years, both U.S. and foreign broker-dealers have argued that the Rule is impractical and does not reflect current business practice. The proposed amendments, which are part of the SEC's broader plan to reduce regulatory obstacles to cross-border financial transactions, are intended to liberalize Rule 15a-6. While these amendments will lessen the burdens on intermediating U.S. broker-dealers in a Rule 15a-6 relationship with a foreign broker-dealer, by significantly expanding the types of persons foreign broker-dealers are permitted to contact and by drastically reducing the chaperoning requirement in the current Rule, the proposal would allow foreign broker-dealers to conduct regular business with qualified investors in the U.S. The comment period for the proposal closes on September 8, 2008.

I. The Current Rule's Requirements

Rule 15a-6, as currently in effect, essentially exempts foreign broker-dealers from registration in the U.S. in four circumstances:

- (1) where the foreign broker-dealer effects unsolicited transactions;
- (2) where the foreign broker-dealer furnishes research reports to "major U.S. institutional investors" and effects transactions in the securities discussed in those reports with those investors under certain conditions;
- (3) where the foreign broker-dealer works with a U.S.-registered broker-dealer to effect a transaction for "U.S. institutional investors" and "major U.S. institutional investors" in accordance with all of the provisions of Rule 15a-6(a)(3) (often referred to as the "chaperoning exemption," and discussed further below); and

¹ See Release No. 34-58047 (June 27, 2008), 73 FR 39182 (July 8, 2008).

- (4) where the foreign broker-dealer effects transactions in securities with registered broker-dealers, banks, various international agencies, foreign persons temporarily in the U.S. with whom it has a bona-fide pre-existing relationship, and certain U.S. persons outside the U.S. (commonly referred to as the "broker-to-broker" exception).

Under current Rule 15a-6(b)(7), a "U.S. institutional investor" is defined as an investment company registered with the Commission under Section 8 of the Investment Company Act of 1940, or a bank, savings and loan association, insurance company, business development company, or employee benefit plan defined in Rule 501(a)(1) of Regulation D under the Securities Act of 1933; a private business development company defined in Rule 501(a)(2) of Regulation D; an organization described in section 501(c)(3) of the Internal Revenue Code, as defined in Rule 501(a)(3) of Regulation D; or a trust defined in Rule 501(a)(7) of Regulation D.² Although the Rule also defines "major U.S. institutional investor," the definition was subsequently expanded in a staff no-action letter to include any entity that owns or controls (or, in the case of investment advisers, has under management) in excess of \$100 million in aggregate financial assets.³

As noted above, current Exchange Act Rule 15a-6(a)(3) permits a foreign broker-dealer to have limited direct contacts with U.S. institutional and major institutional investors without broker-dealer registration in the U.S. provided it "effects" any related transactions through a U.S. registered broker-dealer. Under the Rule, the U.S. broker-dealer must be responsible for:

- effecting the transactions, "other than negotiating their terms;"

² Notably, it does not include corporations that are not one of the enumerated types of entities.

³ See Letter re: Securities Activities of U.S.-Affiliated Foreign Dealers (pub. avail. April 9, 1997) (the "9-Firms Letter"). Before this no-action letter, the term "major U.S. institutional investor" included only "U.S. institutional investors" that had, or had under management, in excess of \$100 million in total assets, and registered investment advisers with more than \$100 million under management. While under the Rule language itself, a corporation not in one of the enumerated categories of entity would not have been a "U.S. institutional investor," and therefore could not have been a "major U.S. institutional investor," under the 9-Firms Letter, if the corporation had more than \$100 million of assets, it would be deemed a "major U.S. institutional investor."

- issuing all required confirmations and statements to the U.S. investor;
- extending or arranging for the extension of any credit to the U.S. investor in connection with the transactions;
- maintaining required books and records of the transactions (*e.g.*, those required under Exchange Act Rules 17a-3 and 17a-4);
- complying with Exchange Act Rule 15c3-1 [the SEC's net capital rule] with respect to the transactions; and
- receiving, delivering and safeguarding funds and securities in connection with the transactions on behalf of the U.S. investor in compliance with Exchange Act Rule 15c3-3.

The foreign broker-dealer is generally required to provide the Commission, upon request, with access to its books and records. Furthermore, foreign associated persons of the foreign broker-dealer must meet certain requirements, such as residence outside the U.S. and that they not be subject to statutory disqualifications. The U.S. broker-dealer must obtain from the foreign broker-dealer the types of information required by Exchange Act Rule 17a-3(a)(12) with respect to each foreign associated person involved in the transactions, as well as written consent to service of process for any civil action brought by or before the SEC or SRO from the foreign broker-dealer and each foreign associated person.

The reason it is referred to as the "chaperoning rule" is that the U.S. broker-dealer must participate through an associated person in all oral communications between the foreign associated person and the U.S. institutional investor, other than a major U.S. institutional investor, except that foreign associated persons may engage in oral communications with institutional investors from outside the U.S. where the communication takes place outside of the trading hours of the NYSE, so long as the foreign associated persons do not accept orders to effect transactions other than those involving foreign securities.

Failure to comply with each of the requirements of the Rule, as modified by various SEC staff no-action letters, might lead to a determination that the foreign broker-dealer

is conducting a broker-dealer business within the U.S., thereby necessitating registration in the U.S.

II. The Proposed Amendments

A. Use of the "Qualified Investor" Standard

The proposed amendments to Rule 15a-6 expand the categories of persons with whom foreign broker-dealers may have contact by replacing the terms "U.S. institutional investor" and "major U.S. institutional investor" with the single term "qualified investor." According to the Commission, the persons and entities covered by this definition "would more accurately encompass persons that have prior experience in foreign markets and an appropriate level of investment experience and sophistication overall."⁴ The term "qualified investor" is already defined in Section 3(a)(54) of the Exchange Act and includes, among other persons:

- registered investment companies;
- issuers excluded from the definition of investment company under Section 3(c)(7) of the Investment Company Act of 1940 (*e.g.*, hedge funds);
- banks, savings associations, brokers, dealers, insurance companies, or business development companies;
- certain employee benefit plans (but not individual retirement accounts);
- certain trusts;
- any associated person of a broker or dealer that is not a natural person;
- any corporation, company, partnership or natural person that owns and invests, on a discretionary basis, not less than \$25 million in investments; and
- any multinational or supranational entity or any agency or instrumentality thereof.

Notably, application of this definition lowers the assets threshold from \$100 million to \$25 million and also expands

⁴ Release No. 34-58047, 73 FR at 39186.

the types of U.S. persons that foreign broker-dealers may contact to include natural persons.

B. Unsolicited Transactions and Quotation Systems (Rule 15a-6(a)(1))

The SEC is not proposing to change the provisions of the unsolicited transaction exemption found in Rule 15a-6(a)(1). In the SEC's view, as a matter of policy, the protections afforded by U.S. registration are not necessary for those U.S. persons who actively seek out a foreign broker-dealer on their own to conduct a transaction in a foreign market. The SEC additionally believes that the unsolicited transaction exemption in Rule 15a-6 has been of limited usefulness in the context of foreign broker-dealer's quotes over quotation systems because of the SEC's historically broad interpretation of the term "solicitation."⁵ Previously, the SEC took the position that a solicitation would not have occurred for purposes of Rule 15a-6 if there were a U.S. distribution of foreign broker-dealers' quotations by third-party systems (*e.g.*, those operated by foreign markets or private vendors) that distributed the quotations primarily in foreign countries and those systems did not permit transactions by U.S. persons and the foreign broker-dealers through the systems. Because it believes that quotation systems are no longer geographically limited, the SEC has proposed to issue a new interpretation to the effect that U.S. distribution of foreign broker-dealers' quotations by a third-party system (which does not allow securities transactions to be executed between the foreign broker-dealer and persons in the U.S. through the system) 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.

Among other things, the SEC seeks comment on whether the proposed interpretation should be limited to third-party systems or whether it should be expanded to include proprietary quotation systems, and whether it should include systems that provide indications of interest as opposed to quotes. In addition, the SEC seeks comment on whether it should amend Regulation ATS to permit foreign broker-dealers that are exempt from registration in the U.S. pursuant to Rule 15a-6 to operate an alternative trading system in the U.S. as long as they comply with all

⁵ *Id.*, 73 FR at 39187.

of the requirements of Regulation ATS except the requirement that they be registered broker-dealers.

C. Research Reports (Rule 15a-6(a)(2))

Under the proposal, the reference in Rule 15a-6(a)(2) to "major U.S. institutional investors" would be changed in favor of "qualified investors." As a result, without registering in the U.S., foreign broker-dealers would be permitted to distribute research reports to qualified investors and effect transactions for qualified investors in the securities covered by the research reports provided the following conditions are satisfied:

- the reports do not recommend the use of the foreign broker-dealer to effect trades;
- the foreign broker-dealer does not initiate contact with those qualified investors to follow up on the reports or otherwise induce or attempt to induce them to purchase or sell any securities;
- if the foreign broker-dealer has a relationship with a U.S.-registered broker-dealer that satisfies the requirements of the rules related to the solicited transactions exemption in Rule 15a-6(a)(3), any transactions in the securities described in the reports must be effected with that registered broker-dealer in accordance with that exemption; and
- the foreign broker-dealer does not provide research reports to U.S. persons with any express or implied understanding that the U.S. persons will direct commission income to the foreign broker-dealer.

This provision would remain largely unchanged under the proposal. The SEC nevertheless seeks comment, among other things, on whether any of the conditions of the Rule should be amended because the class of persons to whom research reports may be distributed directly under the Rule is expanding, or because of the increasing internationalization in securities markets and advancements in technology and communications services since the original adoption of the Rule.

D. Solicited Transactions (Rule 15a-6(a)(3))

As proposed, Rule 15a-6(a)(3) would be substantially revised to eliminate the "chaperoning" requirement of the

current rule and replace it with two alternative exemptive approaches. Under each approach, the U.S. broker-dealer engaged by the foreign broker-dealer to facilitate transactions with U.S. qualified investors has fewer obligations than under the current rule and the foreign broker-dealer may play a larger role in the transactions. The first approach, found in proposed Rule 15a-6(a)(3)(iii)(A)(1), is available only to those foreign broker-dealers conducting a “foreign business” and permits the foreign broker-dealer to custody funds and securities of U.S. qualified investors.⁶ The second approach, found in proposed Rule 15a-6(a)(3)(iii)(A)(2), is available to all foreign broker-dealers.⁷

Under both of these exemptions, the foreign broker-dealer is required to:

- provide the SEC with documents and information pertaining to the transaction(s) upon request;
- determine that its associated persons involved in the transaction(s) are not statutorily disqualified persons;⁸
- have in its files, and make available on request to the SEC and a registered broker-dealer that has taken responsibility for the foreign broker-dealer’s

⁶ “Foreign business” would be defined as the business of a foreign broker-dealer with qualified investors and foreign resident clients where at least 85% of the aggregate value of the securities purchased or sold in transactions conducted pursuant to both Rule 15a-6(a)(3) and 15a-6(a)(4)(vi) of the proposed rule by the foreign broker-dealer, calculated on a rolling two-year basis, is derived from transactions in foreign securities (including foreign equity and debt, as well as U.S. debt securities distributed wholly outside the U.S. pursuant to Regulation S, certain government securities, and certain derivatives that reference foreign securities (but not derivatives that are not considered securities, such as swaps)). See proposed Rule 15a-6(b)(3). This definition is intended to limit the availability of regulatory arbitrage opportunities for foreign broker-dealers regarding their U.S. market activities because their U.S. activities would be limited. We note, however, that a foreign broker-dealer seeking to rely on this exemption would have to make what would appear to be time-intensive and complicated calculations on an annual basis. This area may be the subject of considerable comment.

⁷ The SEC refers to them as “Exemption (A)(1)” and “Exemption (A)(2).” See 73 FR at 39188.

⁸ Under the current Rule, the U.S. broker-dealer is required to determine that the chaperoned associated person of the foreign broker-dealer is not subject to a statutory disqualification as specified in Section 3(a)(39) of the Exchange Act. Under the proposed rule, this burden is shifted from the U.S. broker-dealer to the foreign broker-dealer.

transactions under the Rule, a questionnaire or application of the type required by Exchange Act Rule 17a-3(a)(12) for each of its associated persons; and

- disclose to the qualified investor that it is regulated by a foreign regulatory authority, and that it is not regulated by the SEC.

In addition, the foreign associated person of the foreign broker-dealer effecting transactions with the U.S. qualified investor must conduct all securities activities from outside the U.S., except that he or she may conduct visits to qualified investors within the U.S., provided that the transactions in any securities discussed during visits by the foreign associated person with qualified investors are effected in accordance with Rule 15a-6(a)(3).⁹

Under both Exemptions (A)(1) and (A)(2) of Rule 15a-6(a)(3), the intermediating U.S. broker-dealer must obtain from the foreign firm and each of its foreign associated persons written consent to service for any SEC or SRO civil actions.¹⁰ Furthermore, it must obtain a representation that the foreign broker-dealer has complied with the requirements of Rule 15a-6(a)(3)(i)(B) and (C) [*i.e.*, it has determined that its involved foreign associated persons are not statutorily disqualified and that it maintains appropriate questionnaires relating to its associated persons in its books and records] and must maintain a written record of those representations.¹¹

The additional requirements specific to each of Exemption (A)(1) and Exemption (A)(2) are detailed below.

1. Proposed Rule 15a-6(a)(3)(iii)(A)(1) – Exemption (A)(1)

Proposed Exemption (A)(1) would be limited to foreign broker-dealers that are regulated for conducting securities activities (such as effecting transactions in securities), including the specific activities in which the foreign broker-dealer engages with the qualified investor, in a foreign country by a foreign securities authority. In addition to the general disclosure relating to the firm’s regulation by a foreign securities authority and not the SEC, a foreign

⁹ The concept of “visits” is discussed below.

¹⁰ See Proposed Rule 15a-6(a)(3)(iii)(B).

¹¹ See Proposed Rules 15a-6(a)(3)(iii)(C) and (D).

broker-dealer relying on this exemption is required to disclose that any funds and securities held by the foreign broker-dealer are not subject to U.S. requirements regarding the segregation of customer funds and assets from the broker-dealer's own proprietary holdings, and are not subject to U.S. bankruptcy or SIPA protections.

Under Exemption (A)(1), the U.S. broker-dealer would be required to maintain copies of all books and records, including confirmations and statements issued by the foreign broker-dealer to the qualified investor, relating to the transactions. These records, however, could be maintained in the form, manner and for the periods prescribed by the applicable foreign regulatory authority, and may be maintained with the foreign broker-dealer if the U.S. broker-dealer makes a reasonable determination that the books and records could be provided to the SEC promptly upon request.¹²

Most of the requirements previously assigned to the intermediating U.S. broker-dealer under Rule 15a-6(a)(3) would be eliminated under Exemption (A)(1). The intermediating U.S. broker-dealer would not be required to extend or arrange for credit, issue confirmations and account statements, or comply with Exchange Act Rules 15c3-1 and 15c3-3 with respect to the transactions and the related funds and securities. In addition, it would not be required to maintain accounts for the customers of foreign broker-dealers relying on Exemption (A)(1).¹³ According to the SEC, the intermediating U.S. broker-dealer would no longer be required to effect all aspects of the transaction, and therefore would not be required to comply with the U.S. securities law and regulations and SRO rules applicable to a broker-dealer effecting a securities transaction. The SEC notes, however, that if the

¹² According to the release, the U.S. broker-dealer would need to consider whether there were any foreign legal impediments that would impede the production of such documents. 73 FR at 39189. The SEC asked for comment on whether, instead of requiring the U.S. broker to make this determination, it should require the foreign broker-dealer to file an undertaking with the SEC that it will produce such records at the request of the SEC or U.S. registered broker-dealer, and on whether the "promptly" production standard was appropriate.

¹³ Because accounts would no longer be required to be maintained for these persons, U.S. broker-dealers may not be required to comply with the Bank Secrecy Act-related provisions of Exchange Act Rule 17a-8 with respect to these persons. In this regard, the SEC asks for comment as to whether this portion of the Exemption, which would allow a foreign broker-dealer to effect securities transactions on a solicited basis, presents any concerns with respect to Rule 17a-8 or anti-money laundering obligations under the Bank Secrecy Act.

transaction with the foreign broker-dealer was effected on a national securities exchange, through a U.S. alternative trading system, or with a market-maker or OTC dealer in the U.S., a U.S. registered broker-dealer would be involved and would be required to comply with the provisions of the federal securities laws and rules and SRO rules applicable to such activity. It appears that the SEC is trying to make clear that the U.S. registered broker-dealer involved in effecting such a trade (which could be a different broker-dealer than the intermediating U.S. broker-dealer) continues to be responsible for complying with these provisions for that trade despite the provisions in Exemption (A)(1). Strangely, however, the SEC goes on to state that the federal securities laws and rules and SRO rules "would apply with respect 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." The meaning of this statement is not clear.¹⁴

2. Proposed Rule 15a-6(a)(3)(iii)(A)(2) – Exemption (A)(2)

As noted above, Exemption (A)(2) may be used by any foreign broker-dealer, not just those foreign broker-dealers conducting a "foreign business" as that term is defined in the proposed Rule. Under this Exemption, the foreign broker-dealer is not permitted to custody the U.S. qualified investor's funds and securities involved in any resulting transactions; rather, the U.S. broker-dealer is required to receive, deliver and safeguard the qualified investor's funds and securities in connection with the transaction(s) in accordance with Exchange Act Rule 15c3-3 and to maintain books and records, including copies of all confirmations issued by the foreign broker-dealer to the qualified investor, relating to any resulting transactions.¹⁵ As with Exemption (A)(1), the U.S. broker-dealer would not be required to effect any resulting transaction, so that the U.S. broker-dealer would not be required to comply with the U.S. securities laws and rules and applicable SRO rules in connection with the transaction "unless it were

¹⁴ It is possible that the SEC is attempting to draw a distinction between transactions by foreign broker-dealers for U.S. qualified investors in the U.S. and outside of the U.S., or it could be that they are trying to draw a distinction between the treatment of transactions in U.S. securities and foreign securities under the Rule. The proposed Rule itself, however, does not distinguish between the treatment of U.S. and foreign securities.

¹⁵ See Proposed Rules 15a-6(a)(3)(iii)(A)(2)(i) and (ii).

otherwise involved in effecting the transaction.”¹⁶ The SEC went on to repeat its assertion that the federal securities laws and rules and SRO rules “would apply with respect to all transactions in U.S. securities under Exemption (A)(2) other than certain over-the-counter transactions that a foreign broker-dealer does not effect by or through a U.S. registered broker-dealer.”¹⁷

The SEC believes that this Exemption is likely to be used by qualified investors that like to access foreign broker-dealers but also want an account, and to custody their funds and securities, with a U.S. registered broker-dealer. Because the foreign broker-dealer would not be acting as custodian, the SEC does not believe that it is necessary to include all of the requirements of Exemption (A)(1) in this Exemption, particularly the requirement that the foreign broker-dealer conduct a foreign business.¹⁸ In this regard, however, the SEC seeks comment on whether the proposed disclosures – which do not include the disclosures required under Exemption (A)(1) that the qualified investors’ funds and securities held by the foreign broker-dealer are not subject to segregation and are not protected by U.S. bankruptcy laws or SIPC – would provide sufficient notice that the foreign broker-dealers are not subject to the same regulatory requirements as U.S. registered broker-dealers. In addition, the SEC seeks comment on whether the Exemption should nevertheless be available where the U.S. broker-dealer does not custody the qualified investors’ funds and securities (e.g., where a U.S. or foreign affiliate of the U.S. broker-dealer custodies the funds and securities otherwise than in accordance with Exchange Act Rule 15c3-3). The SEC also seeks comment on whether there should be different requirements for transactions in foreign securities and U.S. securities.

3. Removal of the Chaperoning Requirement

As noted, the SEC proposes to eliminate the current Rule’s chaperoning requirement by which the intermediating U.S. broker-dealer is required to accompany, in some cases, a foreign associated person in his or her contacts with U.S. institutional investors, and to take responsibility for statements made during those contacts. If the proposal is

adopted as proposed, associated persons of a U.S. broker-dealer would no longer be required to participate in oral or electronic communications between foreign associated persons and qualified investors.

Under the amended Rule, the foreign associated person of the foreign broker-dealer effecting transactions with the U.S. qualified investor would be required to conduct all securities activities from outside the U.S. except that he or she may conduct visits to the qualified investors within the U.S., provided that transactions in any securities discussed during visits by the foreign associated person and the qualified investors are effected pursuant to Rule 15a-6(a)(3). These visits would not be required to be chaperoned by the U.S. broker-dealer’s associated persons. According to the SEC, whether a foreign associated person’s stay in the U.S. would be a “visit” is a facts-and-circumstances analysis dependent upon, among other things, length and frequency of stays in the U.S. However, to prevent foreign broker-dealers from essentially having a permanent sales force in the U.S., the SEC proposes to define a “visit” to be one or more trips to the U.S. over a calendar year that do not last more than 180 days in the aggregate.¹⁹ Among other things, the SEC has asked for comment as to whether a shorter time period, such as 120, 90, 60 or 30 days a calendar year, might be more appropriate.

E. The “Broker-to-Broker” Exception (Rule 15a-6(a)(4))

As with the current Rule, Rule 15a-6(a)(4) would provide exemptions for foreign broker-dealers that effect securities transactions with certain enumerated groups of persons, including registered broker-dealers, certain international banks and bank organizations, certain foreign persons temporarily present in the U.S. and certain U.S. persons or groups of U.S. persons abroad. According to the SEC, this exemption has been workable for both the foreign broker-dealers and the U.S. entities named, and it is not aware of investor protections concerns arising from this exemption, so it does not propose to amend it.²⁰

The SEC does propose, however, to provide an additional exemption for transactions with U.S. fiduciaries of accounts

¹⁶ See 73 FR at 39193.

¹⁷ *Id.*

¹⁸ See 73 FR at 39193.

¹⁹ The 180-day limit proposed by the SEC is similar to various tax-related residency limits.

²⁰ See 73 FR at 39196.

for “foreign resident clients.”²¹ For purposes of this exemption, a “foreign resident client” would be: “(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 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 subparagraphs (i) and (ii).”²² Under this exemption, a foreign broker-dealer may effect transactions in securities for any U.S. person, other than a registered broker-dealer or a bank acting pursuant to an exemption or exception from the definition of “broker” or “dealer” in the Exchange Act, that acts in a fiduciary capacity for an account of a foreign resident client, provided that the foreign broker-dealer only effects transactions with or for the U.S. person in the U.S. person’s capacity as a fiduciary to an account of a foreign resident client, and obtains and maintains a representation from the U.S. person that the account is managed in a fiduciary capacity for a foreign resident client.

Among other things, the SEC seeks comment on whether additional counterparties and customers should be included in Rule 15a-6(a)(4). In addition, comment is sought on whether a foreign broker-dealer seeking to take advantage of the U.S. resident fiduciary exemption should be required to conduct a “foreign business” and whether the rule should apply to accounts of a U.S. resident fiduciary other than those of foreign resident clients. Interestingly, the SEC does not note that the new exemption is not limited to transactions in foreign securities, contrary to the no-action letter upon which it is based, nor does it seek comment on whether this expansion of current practice is warranted.

²¹ This exemption essentially would codify, and expand, the relief granted in the so-called “7 Firms” no-action letter. 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 (pub. avail. January 30, 1996) (the “7 Firms Letter”). The 7 Firms Letter provided an exemption from Section 15 registration for direct dealings, in connection with transactions in foreign securities, between foreign broker-dealers and U.S. advisers to “Offshore Clients” based on the fiction that trades were not really being conducted in the U.S. where a non-U.S. person was purchasing non-U.S. stocks from a non-U.S. broker and the only U.S. connection was the fact that the client’s adviser was a U.S.-based adviser.

²² See Proposed Rule 15a-6(b)(4). This definition is the same as the definition of “Offshore Client” in the 7 Firms Letter.

F. Familiarization with Foreign Options Exchanges (Proposed Rule 15a-6(a)(5))

The SEC has proposed a new exemption to address the solicitation activities of foreign options exchanges and their members in the U.S.²³ Under this proposed exemption, a foreign broker-dealer, a foreign options exchange and representatives of the foreign options exchange could conduct certain activities or communicate with a qualified investor in ways that otherwise would be considered to involve a solicited transaction. This new exemption would permit a representative of a foreign options exchange to:

- communicate (*e.g.*, through seminars and other programs in the U.S.) with persons that he or she reasonably believes are qualified investors regarding the foreign options exchange, the options on foreign securities traded on the foreign options exchange, and, if applicable, the foreign options exchange’s “OTC options processing service”;
- provide those persons with a disclosure document that provides an overview of the foreign options exchange and the options on foreign securities traded on that exchange, including the differences from standardized options in the U.S. options market and special factors relevant to transactions by U.S. persons in options on the foreign options exchange; and
- only if the qualified investor requests it, provide a list of participants on the foreign options exchange permitted to take orders from the public and any registered broker-dealer affiliates of such participants.²⁴

A foreign broker-dealer would be permitted make its OTC options processing service available to qualified investors and could provide qualified investors, in response to an unsolicited inquiry concerning options on foreign securities traded on the foreign options exchange, with a disclosure document similar to that provided by the exchange

²³ This exemption will essentially codify relief previously granted by the SEC staff through no-action letters.

²⁴ See Proposed Rule 15a-6(b)(5)(i). These rules are intended to ensure that a foreign options exchange and its representatives do not engage in solicitation on behalf of a particular foreign broker-dealer or limited group of particular foreign broker-dealers. See 73 FR at 39197.

representative described above.²⁵ Finally, a foreign exchange may make available to qualified investors through the foreign broker-dealer the foreign options exchange's OTC options processing service.²⁶

For purposes of this exemption, an "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 of the over-the-counter options."²⁷ According to the SEC, "by utilizing an OTC options processing service, qualified investors would be able to take advantage of the flexible nature of the OTC options market, while realizing certain efficiencies and benefits available in an exchange-traded market. In particular, qualified investors would have greater opportunities to close out options positions."²⁸ So that the foreign options exchange would not be found to be a national securities exchange required to register pursuant to Section 6 of the Exchange Act by virtue of providing access to its "OTC options processing service," the SEC has proposed to provide interpretive guidance to make clear that, if a foreign options exchange, its representatives or its foreign broker-dealer members engage in the limited activities and communications permitted under proposed new Rule 15a-6(a)(5), the foreign exchange would not be subject to registration in the U.S. The SEC's preliminary view is that, "although a foreign exchange's OTC options processing service may be a facility of an exchange, the OTC options processing service would not effect any transaction in a security or report any such transaction. Accordingly, such activity would not trigger the registration requirements of Section 6 of the Exchange Act."²⁹

²⁵ See Proposed Rule 15a-6(b)(5)(ii).

²⁶ See Proposed Rule 15a-6(b)(5)(iii).

²⁷ See Proposed Rule 15a-6(b)(6).

²⁸ See 73 FR at 39197.

²⁹ See 73 FR at 39198.

For Further Information

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