CLIENT ALERT

SEC Issues Much Needed Guidance on Rule 15a-6 Regarding Foreign Broker-Dealers

Mar.25.2013

The Securities and Exchange Commission ("SEC") issued guidance in the form of FAQs on March 21, 2013 that clarify certain issues that have arisen under Rule 15a-6 of the Securities Exchange Act of 1934, as amended (the "Exchange Act") ("Rule 15a-6"). Rule 15a-6 provides guidance to foreign broker-dealers ("FBDs") regarding U.S. broker-dealer registration requirements related to FBDs' conduct of business in the United States or with U.S. citizens and residents. Adopted in 1989 and later amplified by two SEC No Action Letters known as the Seven Firms Letter (which expanded the definition of major institutional investor to include unregistered investment advisors with over $100 million under management) and the Nine Firms Letter (which allows expanded contacts and certain unchaperoned activities) (collectively, the "Rule"), the Rule permits FBDs to conduct business in the U.S. without registering as U.S. broker-dealers provided certain conditions are met.

The general circumstances under which U.S. registration of an FBD is not required pursuant to the Rule include: (i) doing business that is unsolicited; (ii) sending research reports to U.S. major institutional investors (investors that have or have under management in excess of $100 million); (iii) conducting securities business with major institutional investors and institutional investors (which category includes banks, S&Ls, registered investment companies, insurance companies, business development companies, SBICs, and certain employee benefit plans, private business development companies and trusts), that is chaperoned by a U.S. broker-dealer; and (iv) effecting or attempting to induce transactions in securities by certain classes of investors, including, among others, foreign persons temporarily resident in the U.S. with whom the FBD had a bona fide relationship before the foreign person entered the U.S.

In the last few years the SEC has been asked to address questions that have arisen regarding interpretations by FINRA and the industry of various provisions of the Rule, including issues regarding whether chaperones must be affiliated with the FBD, net capital requirements for chaperoning broker-dealers, charges for failed transactions, activities that might not be deemed solicitation of U.S. investors, and the definition of foreign persons temporarily residing in the U.S. Key portions of the SEC's FAQs are summarized below.

Must a chaperoning broker-dealer under Rule 15a-6(a)(iii) be affiliated with the FBD in order to rely on the Nine Firms letter or the Seven Firms Letter?

No.

What are the net capital requirements for chaperoning broker-dealers?

A chaperoning broker-dealer has a minimum net capital requirement of $250,000, including situations where the FBD's business is conducted only on a delivery versus payment/receive versus payment (DVP/RVP) basis:

- it has a written, fully disclosed clearing arrangement with a broker-dealer that has agreed to comply with the SEC's broker-dealer financial responsibility rules with respect to the chaperoning arrangement, in which case the minimum

net capital requirement is $5,000 or whatever level is otherwise required by the nature of the chaperone's activities (and the chaperone and the FBD may rely on all terms of the Nine Firms Letter); or
- it only engages in M&A activities, in which case the minimum net capital requirement is $5,000.

If a U.S. broker-dealer relies on the Exchange Act Rule 15c3-3(k)(2)(i) exception from custody and protection of customer assets requirements and maintains net capital of $100,000, it may not chaperone or rely on the Nine Firms Letter unless it either enters into an arrangement with a carrying broker that agrees in writing to comply with the SEC's financial responsibility rules with respect to chaperoning arrangements or increases its capital to $250,000.

What activities can an FBD engage in that would not be deemed to be soliciting business from U.S. citizens or residents and thus be required to register as a U.S. broker-dealer?

- FBDs may conduct business with any foreign persons temporarily residing in the U.S. with whom the FBD has a bona fide pre-existing business relationship other than U.S. citizens or permanent residents with a "green card."
- An FBD that acts as administrator for an employee stock ownership plan (ESOP) of a foreign issuer will be deemed to have solicited the issuer, not its U.S. employees, and thus not required to register, if it limits its activities to the following: (i) the FBD deals only with management and benefit plan representatives; (ii) the FBD sends written communications to, and facilitates transfer of, the foreign issuer's foreign securities for the U.S. employees; and (iii) the FBD sells the foreign issuer's foreign securities for the U.S. employees.
- An FBD may send account statements and confirmations, as well as other documents required under foreign law, to U.S. investors when an unsolicited transaction has occurred, or, in a chaperoned relationship, may send confirmations and account statements to U.S. customers when required under foreign law or internal policies. In the latter case, the chaperone must ensure that the confirmations comply with U.S. law, including Exchange Act Rule 10b-10 as well as with applicable self-regulatory organization (SRO) rules, and must identify the U.S. broker-dealer on behalf of which the document is sent.
- An FBD will not be deemed to engage in solicitation merely because more than one transaction is effected for a U.S. customer. However, a course of transactions will be deemed to be indicative of efforts by the FBD of attempts to establish an ongoing business relationship with a U.S. customer. The SEC staff emphasized the facts and nature of this issue and encouraged firms to seek relief on a case-by-case basis.

What are the requirements for chaperones when the FBD sends research directly to U.S. persons?

The chaperone has no obligations with respect to such research; however, any transactions in the securities covered in the research must be effected through the chaperoning broker-dealer, and if the chaperone receives a copy of the research from any source, the chaperone must retain a copy.

Must the chaperone take a charge for a failed transaction if the FBD is required to take such charge?

Yes, unless the chaperone's clearing firm takes the charge for the fail. The SEC staff reminded members that they are responsible for timely obtaining accurate information regarding fails and updating the chaperone's books and records accordingly, noting that firms may download such information from the FBD.

Please click here to link to the SEC's FAQs.

For more information, please contact the professional(s) listed below, or your regular Crowell & Moring contact.

Linda Lerner
Senior Counsel – New York
Phone: +1 212.803.4073
Email: llerner@crowell.com