Forum for | US Securities Lawyers | in London

Nancy M. Morris
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
United States

September 8, 2008

**File No. S7-16-08 – Exemption of Certain Foreign Brokers or Dealers [Corrected] No. 34-58047**

Dear Ms. Morris,

We are submitting this letter in response to the request of the U.S. Securities and Exchange Commission (the "**Commission**") for comments in respect of the Commission's proposal (the "**Proposal**") to revise Rule 15a-6, as promulgated under the Securities Exchange Act of 1934, as amended (the "**Exchange Act**"). The Forum for U.S. Securities Lawyers in London (the "**Forum**") is a trade association representing a large number of U.S.-qualified lawyers practicing at a number of law firms and financial institutions in the London capital markets, as well as market participants including securities exchanges, settlement systems and registrars. Founded in 2006, the Forum is an independent, self-funded organization dedicated to addressing issues of, application of, and compliance with, U.S. securities laws in the London and international capital markets. We are submitting this letter on behalf of certain members of the Forum who are signatories of this letter.

We strongly support the Commission's efforts to expand the scope of activities that a foreign broker-dealer could conduct in the United States without the need for registration. We also support the increased direct access, the simplification of procedures and the increased interaction with U.S. investors that these Proposals envisage. We are limiting our comments to certain points that we perceive as being particularly relevant to the European and London capital markets.

We wish to comment in respect of the following issues:

## 1. Definition of "Qualified Investors"

The Proposal contemplates that the furnishing of research reports in accordance with proposed revised Rule 15a-6(a)(2) and the solicitation and the conduct of solicited trades pursuant to proposed revised Rule 15a-6(a)(3) be permitted to be made to persons that are "qualified investors" within the meaning of section 3(a)(54) of the Exchange Act. In general, we applaud the Commission's efforts to "expand the category of U.S. investors with which a foreign broker-dealer could interact under Rule 15a-6(a)(2) and…expand, with a few exceptions the category of U.S. investors with which a foreign broker-dealer could interact under Rule 15a-6(a)(3)…."[1] We are concerned, however, that the adoption of the "qualified investor" standard in the form proposed would, in fact, be a significant retreat from the existing "major U.S. institutional

[1] We also note that the concept of "qualified investor" has also been used to define the parameters of permitted contacts by Australian broker-dealers who are granted exemptions by the Commission under the bilateral agreements between the Commission and the Australia securities regulators under the recently announced mutual recognition framework.

investor" and "U.S. institutional investor" standards as well as the decade-old market practice that has developed in reliance two letters from the Commission's staff in April 1997 (together, the "**1997 Staff Letters**")[2].

Under existing Rule 15a-6, "U.S. institutional investor" is defined to include investment companies registered under section 8 of the Investment Company Act of 1940 and certain, specified institutional entities (including, among other things, banks, savings and loans, insurance companies and certain employee benefit plans) whilst "major U.S. institutional investor" is defined to include U.S. institutional investors that have or have under management in excess of $100 million as well as investment advisers that registered under US Investment Adviser Act of 1940. However, if adopted as proposed, the definition of "qualified investor" does not include registered investment advisers. Although paragraph (xi) of section 3(a)(54) includes within the definition of "qualified investor" "any corporation, company or partnership that owns *and* invests on a discretionary basis, not less than $25,000,000" (emphasis added) and paragraph (xii) of section 3(a)(54) includes "any natural person who owns *and* invests on a discretionary basis, not less than $25,000,000" (emphasis added), this would not include many, if not most, investment advisers, which control (or have under management) but do not themselves own the investments.[3]

Moreover, through the 1997 Staff Letters, the staff of the Commission extended, on a no-action basis, the concept of major U.S. institutional investor to "any entity that owns or controls (or, in the case of an investment adviser, has under management) in excess of $100 million in aggregate financial assets" ("**$100 Million Entities**"). The staff clarified that this concept of $100 Million Entities would extend to unregistered investment advisers that had at least $100 million under management. The 1997 Staff Letters were issued in response to requests that highlighted that the definition of major U.S. institutional investor excluded, amongst other things, investment advisers that were not registered with the Commission and other entities, such as corporations and partnerships that own or control (or in the case of investment advisers, have under management) in excess of $100 million and have a similar level of sophistication to major U.S. institutional investors. The extension of the audience for exempt distribution of research reports under Rule 15a-6(a)(2) and exempt solicited trade activities under Rule 15a-6(a)(3) to $100 Million Entities has been in line with the structure of the broker-dealer industry and has not led to any abuses of which we are aware. It is also broadly consistent with the concept of "qualified institutional buyers" under Rule 144A of the Securities Act of 1933, as amended (the "**Securities Act**"). However, the proposed definition of qualified investor would include only some of those $100 Million Entities with whom foreign broker-dealers can currently transact under Rule 15a-6(a)(2) and Rule 15a-6(a)(3). Under paragraph (xi) of section 3(a)(54), those that do not own *and* invest on a discretionary basis would be excluded (regardless of the amount of investments or assets controlled or under management) while for those that both own and invest on a discretionary basis an even lower threshold of $25 million in assets would be included. Such a result is neither principled nor likely intended by the Commission.[4]

Accordingly, we strongly suggest that the Commission modify the definition of "qualified investor" for purposes of Rule 15a-6 such that a qualified investor would be "any corporation, company or partnership that owns *or* invests on a discretionary basis (or, in the case of an investment adviser, has under management) not less than $25,000,000 in investments". Congress has

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[2] Letter from Richard R. Lindsey, Director, Division of Market Regulation, to Mr. Giovanni P. Prezioso, Cleary Gottlieb Steen & Hamilton (April 9, 1997) and Letter from Catherine McGuire, Chief Counsel, Division of Market Regulation, to Mr. Giovanni P. Prezioso, Cleary Gottlieb Steen & Hamilton (April 28, 1997).

[3] Although the commentary in the Proposal states that "qualified investor" status includes "corporations, companies, or partnerships that own *or* invest on a discretionary basis $25 million or more in investments" (emphasis added), this is simply not borne out by the text of the statute. Similarly although the Proposal's commentary refers to natural persons that "own *or* invest on a discretionary basis not less than $25 million" as falling within the definition of "qualified investor", this result is not reflected in the actual language of section 3(a)(54).

[4] *See also* note 3 above.

explicitly recognised that the Commission may add to the definition of "qualified investor" when it granted additional definitional authority to the Commission under section 3(a)(54)(c) of the Exchange Act. And it would be appropriate, in light of the financial sophistication of the person, their net worth and their knowledge and experience of financial matters, to do so under the narrow circumstances of the distribution of research reports under Rule 15a-6(a)(2) and the solicitation and transaction of certain trades under Rule 15a-6(a)(3).

## 2. Definition of "Foreign Business"

A foreign broker-dealer will only be exempt from U.S. registration requirements under proposed Rule 15a-6(a)(3)(iii)(A)(1) ("**Exemption A(1)**") if the foreign broker-dealer conducts a "foreign business". The proposed rule defines "foreign business" to mean the business of a foreign broker-dealer with qualified investors under 15a-6(a)(3) and foreign resident clients under 15(a)-6(a)(4)(vi) where at least 85% of the aggregate value of the securities purchased or sold in transactions are in "foreign securities." The 85% threshold would then be calculated on a two-year rolling basis.

We respectfully contend that the calculation and maintenance of such records would be very difficult, if not impossible and unreasonably burdensome under existing trading and settlement systems generally in Europe and specifically in London. The proposed rule would define "foreign securities" in relation to equity securities as securities of a "foreign private issuer" as defined in Rule 405 ("**Rule 405**") of the Securities Act. We think it would be difficult for a non-U.S. broker-dealer in the London and other European markets to be able to determine the relevant factors listed in Rule 405 for compliance monitoring purposes:

(A) whether 50% of an issuer's voting securities are owned directly or indirectly by United States residents; and

(B) whether one of the three requirements below are also applicable:

(1) whether the majority of the executive officers or directors of the issuer are United States citizens or residents;

(2) whether more than 50% of the assets of the issuer are located in the United States; and

(3) whether the business of the issuer is administered principally in the United States.

Much of this information is not readily available nor can it be easily found in the public domain. Although the status of U.S. issuers is disclosed on the London Stock Exchange while the equity securities of such issuers are in the one-year distribution compliance period under Regulation S, the markers and other methods used to identify them are typically removed once this period has ended. Moreover, while those securities that are registered under section 12 of the Exchange Act or required to file periodic statements with the Commission under section 15(d) of the Exchange Act identify their status by their selection of a reporting form (i.e. Form 20-F or Form 10-K), this information is not available for those issuers the securities of which may be offered and sold in the United States (e.g., in reliance on Rule 144A under the Securities Act) but are not reporting companies.

Even more critical is that even with the knowledge of which securities do not qualify as securities of a foreign private issuer, to separate out all such transactions that have been traded and settled electronically would be very costly and unreasonably burdensome.

We respectfully suggest that a better way to determine which foreign broker-dealers qualify as conducting a ‘‘foreign business’’ would be to define “foreign business” to include a business of a foreign broker-dealer with qualified investors and foreign resident clients where:

(A) a non-U.S. broker-dealer would meet the following two requirements to rely on Exemption (A)(1): (1) the broker-dealer’s customer base is comprised of 15% or less U.S. persons; and (2) the volume of sales to those U.S. persons will be less than a certain percentage of the total volume of sales to all customers (the “**Customer Base Test**”). The Customer Base Test alternative would be easier for foreign broker-dealers to apply and monitor with information that they have readily available. The identity of their customers in the first prong would be collected under legal requirements their home country jurisdictions, such as under the Markets in Financial Instruments Directive (“MiFID”)[5] and anti money-laundering or “know your customer” requirements in the European Union. We also believe that the Customer Base Test would meet the concerns of the Commission that the Exemption (A)(1) only be made available to foreign broker-dealers with genuinely non-U.S. businesses and not used to establish an offshore domestic broker-dealer; or

(B) at least 85% of the aggregate value of the securities purchased or sold in transactions are in “foreign securities” where foreign securities is determined for these purposes by the country of primary listing and where the securities are settled (the “**Primary Listing Test**”). The Primary Listing Test would facilitate the collection and maintenance of records for these purposes. The Primary Listing Test would also create clarity in a variety of situations, including: (a) the securities of U.S. companies listed outside of the United States and placed to non-U.S. investors under Regulation S; and (b) dual-listed securities which may trade in multiple jurisdictions.

## 3. Cross-Border Information Sharing

Under Exemption (A)(1) of the Proposal, a foreign broker-dealer would be allowed to maintain the books and records of transactions carried out with “qualified investors”, where previously such records would had to have been maintained by the U.S.-registered broker-dealer. Such books and records, however, must, in the view of the U.S.-registered broker-dealer, be accessible to the Commission upon request. We note that access by the U.S.-registered broker-dealer and/or the Commission to such records maintained by the non-U.S. broker-dealer may be restricted by local privacy laws applicable to the non-U.S. broker-dealer. For example, cross-border sharing of information may raise certain data protection considerations to the extent that at least some of such books and records will or may contain “personal data” covered by the Data Protection Act 1998 in the United Kingdom (the “**DPA**”).

Although we do not believe that the DPA poses insurmountable problems to the organisations wishing to hold data in the United Kingdom and potentially transfer it to the Commission in the United States, we encourage the Commission to consider consulting with the Information Commissioner’s Office in the United Kingdom (the “**UK ICO**”) regarding how such personal data transfers from U.K.-based broker-dealers may be handled, and any resulting recommendations from the UK ICO could then be taken into account prior to formalizing the amendment to the rule.

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[5] MiFID is one of the fundamental pieces of EU legislation emerging under the Financial Services Action Plan. MiFID, among other things, imposes detailed requirements on EU member states in relation to the authorization and regulation of various investment activities and services.

We would be pleased to respond to any enquiries regarding this letter or our views on the Proposal generally. Please contact Sarah Cebik at DLA Piper UK LLP (Tel: +44 (0) 8700 111 111); Katherine Mulhern at Lovells LLP (Tel: +44 (0) 20 7296 2000); *insert name(s)* at Morrison & Foerster (Tel: +44 (0) 20 7920 4000); Paul de Bernier at Mayer Brown International LLP +44 (0) 20 7628 2020); Peter O'Driscoll or Nell Scott at Orrick, Herrington & Sutcliffe LLP (+44 (0)20 7562 5000); or Daniel Winterfeldt at Simmons & Simmons (Tel: +44 (0) 20 7628 2020) if you have any enquiries in relation to this letter.

Respectfully submitted,

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