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REGULATION OF FOREIGN BROKER-DEALERS IN THE UNITED STATES

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I. INTRODUCTION

Advances in technology, greater mobility of investment capital, and relaxation of legal barriers have accelerated the development of global securities markets.[1] As these markets expand, foreign broker-dealers increasingly seek access to markets in the United States to effect transactions with United States investors. Conversely, United States investors show heightened interest in foreign securities.[2]

As United States investors become more active in global markets, however, concern about the sphere of regulation of foreign broker-dealers becomes more acute. The Securities and Exchange Commission (the "Commission") recently adopted rule 15a-6,[3] which provides guidelines under which foreign broker-dealers entering into securities transactions with certain United States persons will not have to register under the

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1. *See generally* Policy Statement of the United States Securities and Exchange Commission on Regulation of International Securities Markets, International Series Release No. 1, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,341 (Nov. 23, 1988); Chuppe, Haworth & Watkins, *The Securities Markets in the 1980s: A Global Perspective* (1989) (SEC staff study); *Internationalization of Securities Markets*, Report of the Staff of the United States Securities and Exchange Commission to the Senate Committee on Banking, Housing and Urban Affairs and the House Committee on Energy and Commerce (1987).

2. *See Seeking a Higher Return Abroad*, N.Y. Times, Feb. 5, 1989, § 3, at 8, col. 3.

3. Exchange Act Release No. 27,017, [Current] Fed. Sec. L. Rep. (CCH) ¶ 84,428 (July 11, 1989) [hereinafter Adopting Release]; *see also* Exchange Act Release No. 25,801, [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,244 (June 14, 1988) [hereinafter Proposing Release].

Securities Exchange Act of 1934 (the "Exchange Act"). At the same time, the Commission published a release that explores and seeks comments concerning an exemption to registration requirements for foreign broker-dealers that would be conditioned on comparable foreign regulation as well as cooperation with foreign securities regulators (the "Concept Release").[4]

II. BACKGROUND

Section 15(a) of the Exchange Act requires registration with the Commission by any broker or dealer using the mails or interstate commerce "to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security (other than an exempted security or commercial paper, bankers' acceptances, or commercial bills)."[5]

Section 30(b), however, provides that:

> the provisions of this chapter or of any rule or regulation thereunder shall not apply to any person insofar as he transacts a business in securities without the jurisdiction of the United States, unless he transacts such business in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate to prevent the evasion of this chapter.[6]

Unless the Commission acts by rulemaking to expand its jurisdiction under the Exchange Act, this provision of section 30(b) might be read to preclude regulation of non-resident broker-dealers who effect securities trades in foreign markets. Nonetheless, the Commission and some courts have interpreted section 30(b) to acknowledge extra-territorial jurisdiction over foreign market professionals, rather than as a limitation of jurisdiction to the territorial boundaries of the United States.[7] Indeed, rule 15a-6

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4. Exchange Act Release No. 27,018, [Current] Fed. Sec. L. Rep. (CCH) ¶ 84,429 (July 11, 1989) [hereinafter Concept Release].

5. 15 U.S.C. § 78o(a)(1) (1988). Section 3(a)(4) defines "broker" as "any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank." 15 U.S.C. § 78c(a)(4) (1988). Section 3(a)(5) defines "dealer" as:

> any person engaged in the business of buying and selling securities for his own account, through a broker or otherwise, but does not include a bank, or any person insofar as he buys or sells securities for his own account, either individually or in some fiduciary capacity, but not as a part of a regular business.

15 U.S.C. § 78c(a)(5) (1988).

6. 15 U.S.C. § 78dd(b) (1988).

7. *See, e.g.*, SEC v. United Financial Group, 474 F.2d 354, 357-58 (9th Cir. 1973) ("jurisdiction" in § 30(b) does not mean "territorial limits"). *But see* Kook v. Crang, 182 F. Supp. 388 (S.D.N.Y. 1960) (section 30(b) restricts Exchange Act to transactions within the United States). According to the Adopting Release, "[t]he Commission's position on

itself assumes that the registration requirements apply to any foreign broker-dealer who solicits United States investors, without reference to whether the foreign broker-dealer is in fact transacting business *within* the United States.

Registration, a key element in the federal statutory scheme for protecting investors,[8] has always been required if a foreign broker-dealer opens a branch or an affiliate in the United States to provide services to persons within the United States. Thus, the regulatory system governing United States broker-dealers applies to the entity operating within the United States. Similarly, employees of the registered entity must be licensed by the appropriate self-regulatory organizations ("SROs") as well as the states in which they operate.

In Securities Act Release No. 4708,[9] the Commission set forth guidelines for determining whether a foreign underwriter of a United States issuer's offering of securities abroad should register as a broker-dealer under the Exchange Act.[10] Registration was not required under these guidelines if a foreign broker-dealer limited its overseas activities to selling securities outside the United States to non-United States persons. If the firm participated in an underwriting syndicate, all United States activities for the syndicate had to be carried out exclusively by a managing underwriter who was so registered.[11]

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the application of section 30(b) historically has been, and continues to be, that the phrase 'without the jurisdiction of the United States' in that section does not refer to the territorial limits of this country." Adopting Release, *supra* note 3, at 80,237 n.41.

8. *See* Concept Release, *supra* note 4, at 80,260; Blaise D. Antoni & Assocs. v. SEC, 290 F.2d 688 (5th Cir.), *cert. denied*, 368 U.S. 899 (1961). Registered broker-dealers must join a self-regulatory organization and the Securities Investor Protection Corporation. They become subject to net-capital regulation, qualification standards, record-keeping and reporting requirements, fiduciary duties, and anti-fraud rules.

9. 29 Fed. Reg. 9828 (1964). The Commission intends to clarify the extra-territorial provision of the Securities Act of 1933 with its proposed Regulation S. Exchange Act Release No. 6838, [Current] Fed. Sec. L. Rep. (CCH) ¶ 84,426 (July 11, 1989).

10. 29 Fed. Reg. 9828 (1964).

11. Following these guidelines, the SEC staff took no-action positions with respect to the sale to foreign investors outside the United States of newly-issued United States securities by United States firms, *see, e.g.*, William Island Assocs., SEC No-Action Letter (May 4, 1983) (LEXIS, Fedsec library, Noact file) (offering of condominium units abroad), and foreign firms, see, *e.g.*, New York Hanseatic Corp., SEC No-Action Letter (July 31, 1968) (copy on file with *New York Law School Law Review*); Ultoomel & Assudamai Co., SEC No-Action Letter (June 14, 1961) (copy on file with *New York Law School Law Review*). The staff also took a no-action position where securities obtained in United States secondary markets through a United States registered broker-dealer were sold by a non-registered securities firm to foreign investors abroad. *See, e.g.*, Bear Stearns & Co. / Sun Hung Kai, SEC No-Action Letter (Jan. 7, 1976) (LEXIS, Fedsec library, Noact file). The United States-registered broker-dealer provides access, and arguably protective insulation, to the United States markets. On the other hand, the staff views foreign broker-dealers as

In the case of broker-dealers operating from abroad and having no physical presence in the United States, however, no-action letters and interpretive advice from the Commission's Division of Market Regulation indicated certain circumstances in which registration was not required.[12]

When foreign broker-dealers dealt with United States investors in the United States under circumstances that suggested solicitation, the staff generally was unwilling to take a no-action position.[13] Solicitation was deemed to include running investment seminars for United States persons,[14] advertising in United States newspapers,[15] publishing quotes in the United States,[16] and providing advice to United States investors about foreign securities.[17] Nonetheless, in instances where a United States registered broker-dealer was willing to assume responsibility for all United States persons' accounts, including order taking, confirmations, and maintaining books and records with respect to the transactions, favorable no-action responses were granted.[18]

These prior interpretations and no-action letters issued by the SEC staff are incorporated in many respects in the new rule 15a-6.[19]

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subject to registration when they specifically target groups of United States persons abroad, *e.g.*, United States military personnel. *See* Roberto Luna, SEC No-Action Letter (Feb. 21, 1967) (copy on file with *New York Law School Law Review*).

12. *See, e.g.*, National Westminster Bank PLC, SEC No-Action Letter, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,881 (July 7, 1988); Security Pacific Corporation, SEC No-Action Letter, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,883 (July 7, 1988) (engaging in securities transactions with registered broker-dealers and banks acting in broker or dealer capacity). These were extended by analogy to the registration requirements for government securities brokers or dealers under section 15C of the Exchange Act, 15 U.S.C. § 78o-5 (1988). Bank of America Canada, SEC No-Action Letter, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,824 (April 1, 1988).

13. *See, e.g.*, Wood Gundy Inc., SEC No-Action Letter, [1985-1986 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,191, at 76,771 (Nov. 8, 1985).

14. *See* Hoare & Govett, Ltd., SEC No-Action Letter (Sept. 28, 1973) (LEXIS, Fedsec library, Noact file).

15. Proposing Release, *supra* note 3, at 89,195.

16. *See* Irving Marmer, SEC No-Action Letter, [1972-1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,283 (Dec. 4, 1972).

17. *See* Wood MacKenzie, SEC No-Action Letter (Aug. 23, 1974) (LEXIS, Fedsec library, Noact file).

18. *See, e.g.*, Smith New Court, SEC No-Action Letter (Aug. 26, 1985) (LEXIS, Fedsec library, Noact file).

19. The approach of incorporating interpretative positions into the rule was suggested by subcommittees of the American Bar Association. *See* Letter from John M. Liftin, on behalf of the Subcommittees on Broker-Dealer Matters and International Matters, Committee on Federal Regulation of Securities, Section of Business Law, ABA, to Jonathan G. Katz, Secretary, SEC (Sept. 14, 1988) (discussing the view expressed by the subcommittees that if the ground rules for exclusions from registration were clearly articulated in the text of the rule rather than through a series of no-action letters and interpretative releases, a more

III. RULE 15a-6

Rule 15a-6 exempts from the registration requirements foreign broker-dealers that engage in certain United States contacts:

> (i) "nondirect" contacts by foreign broker-dealers with [United States] investors and markets, through execution of unsolicited securities transactions, and provision of research to certain [United States] institutional investors; and
>
> (ii) "direct" contacts, involving the execution of transactions through a registered broker-dealer intermediary with or for certain [United States] institutional investors, and without this intermediary with or for registered broker-dealers, banks acting in a broker or dealer capacity, certain international organizations, foreign persons temporarily present in the United States, [United States] citizens resident abroad, and foreign branches and agencies of [United States] persons.[20]

A. Solicitation

A foreign broker-dealer that effects unsolicited transactions in securities for United States-situated customers is exempt from registration.[21] While the Commission declined to define "solicitation," it expressed the view that "the deliberate transmission of information, opinions, or recommendations to investors in the United States, whether directed at individuals or groups, could result in the conclusion that the foreign broker-dealer has solicited those investors."[22]

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efficient and practical system would result); Exchange Act Release No. 26,136, [Current] Fed. Sec. L. Rep. (CCH) ¶ 84,332 (Sept. 30, 1988); Exchange Act Release No. 27,017, [Current] Fed. Sec. L. Rep. (CCH) ¶ 84,428 n.11 (July 11, 1989).

20. Adopting Release, *supra* note 3, at 80,232.

21. 54 Fed. Reg. 30,031 (1989) (to be codified at 17 C.F.R. § 240.15a-6(a)). Foreign broker-dealers are defined as non-United States resident persons that are not offices, branches, or, in the case of natural persons, associated with registered broker-dealers, but whose activities would fall within the definition of "broker" and "dealer" in sections 3(a)(4) or 3(a)(5) of the Exchange Act. Adopting Release, *supra* note 3, at 80,244.

22. Adopting Release, *supra* note 3, at 80,240. The staff would not, however, consider research reports prepared by a foreign broker-dealer to constitute solicitation where the research reports are distributed to United States investors by an affiliated United States broker-dealer and where the United States affiliate, in the research report, states that it accepts responsibility for the research. *Id.* at 80,244.

B. Institutional Investors

Registration will not be required if research materials were furnished to a "major" United States institutional investor, provided the materials recommend using the foreign broker-dealer to effect trades in the security, and the foreign broker-dealer does not take further steps to induce the purchase or sale of any security by those investors.[23] Under these conditions, "the foreign broker-dealer may effect trades in the securities discussed in the research or other securities at the request of major [United States] institutional investors receiving the report."[24] A "major" United States institutional investor is defined as a United States institutional investor or registered investment adviser with assets, or assets under management, exceeding $100 million.[25]

If the foreign broker-dealer has a relationship with a registered broker-dealer that satisfies the requirements of paragraph (a)(3) of the rule, however, all trades of securities discussed in the research report must be effected through the registered broker-dealer pursuant to that exemption.[26] The exemption is available to a foreign broker-dealer that induces or attempts to induce a purchase or sale of a security by an institutional investor, whether or not meeting the criteria of "major," as long as the resulting transactions are effected through a registered broker-dealer.[27] Research provided to such institutions by the foreign

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23. Rule 15a-6(a)(2), 54 Fed. Reg. 30,031 (1989) (to be codified at 17 C.F.R. § 240.15a-6(a)(2)).

24. Adopting Release, *supra* note 3, at 80,246.

25. A United States institutional investor means a registered investment company, bank, savings and loan association, insurance company, business development company, small business investment company, or employee benefit plan defined in rule 501(a)(1) of Regulation D under the Securities Act, 17 C.F.R. § 230.501(a)(1) (1989), a private business development company defined in rule 501(a)(2), 17 C.F.R. § 230.501(a)(2) (1989), an organization described in section 501(c)(3) of the Internal Revenue Code, as defined in rule 501(a)(3), 17 C.F.R. § 230.501(a)(3) (1989), or a trust defined in rule 501(a)(7), 17 C.F.R. § 230.501(a)(7) (1989). *See also* Adopting Release, *supra* note 3, at 80,245 n.108.

26. Rule 15a-6(a)(2)(iii), 54 Fed. Reg. 30,031 (1989) (to be codified at 17 C.F.R. § 240.15a-6(a)(2)(iii)); *see also* Adopting Release, *supra* note 3, at 80,246. A 1987 no-action letter contemplated that Chase Manhattan Capital Markets Corp., a registered broker-dealer affiliate of a United States bank holding company, would provide research prepared by its affiliated non-registered foreign broker-dealer to United States institutional customers. Chase Manhattan Corp., SEC No-Action Letter, [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,518 (July 28, 1987). Under the conditions of the letter, employees of the foreign company were not permitted to initiate telephone conversations with the United States investor. Moreover, a registered representative of the United States registered broker-dealer affiliate must have participated in any interaction resulting from the research between the investor and the foreign broker-dealer. Finally, any resulting orders must have been executed by the United States affiliate.

27. Rule 15a-6(a)(3), 54 Fed. Reg. 30,031 (1989) (to be codified at 17 C.F.R. § 240.15a-

broker-dealer must state conspicuously that the registered broker-dealer accepts responsibility for the content, that any person receiving the research and wishing to effect transactions in covered securities should do so with the registered — not the foreign — broker-dealer, and transactions with recipients must in fact be executed only with, or through, the registered broker-dealer.[28]

Interpositioning of the registered broker-dealer addresses the concerns of financial-responsibility, record-keeping, and enforcement.[29] While the registered broker-dealer has physical possession of required records,[30] a third party may be used, including the foreign broker-dealer, to process the records. Under the rule, the registered broker-dealer may also delegate the execution of trades in foreign markets — but not any other duties — to the foreign broker-dealer.

The registered broker-dealer has the responsibility to review trades arranged by the foreign broker-dealer for indications of securities-law violations.[31] Upon request or pursuant to agreements reached between any foreign securities authority and the Commission or the United States

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6(a)(3)); *see also* Adopting Release, *supra* note 3, at 80,247. A non-resident registered broker-dealer that complies with rule 17a-7(a), 17 C.F.R. § 240.17a-7(a) (1989), may serve as the intermediary. The rule as adopted does not require any affiliation, whether by ownership or control, between the foreign broker-dealer and the registered broker-dealer.

28. Adopting Release, *supra* note 3, at 80,237. The registered broker-dealer is required to extend or handle the extension of any credit in connection with the transaction. This exemption would not be available, however, in the case of soft-dollar arrangements between the foreign broker-dealer and United States persons. *Id.* at 80,246.

29. *Id.* at 80,255. The United States broker-dealer must obtain written consents from the foreign broker-dealer and each foreign individual in contact with United States institutional investors to service of process for any civil action or proceeding conducted by the Commission or an SRO. Rule 15a-6(a)(3)(iii)(D), 54 Fed. Reg. 30,031 (1989) (to be codified at 17 C.F.R. § 240.15a-6(a)(3)(iii)(D)).

30. *See* rules 17a-3 and 17a-4, 17 C.F.R. §§ 240.17a-3, 240.17a-4 (1989). The United States registered broker-dealer would also have responsibility for receipt, delivery, and safeguarding of funds and securities, rule 15c3-3, 17 C.F.R. § 240.15c3-3 (1989), and providing confirmations and statements. The registered broker-dealer would have to maintain all records in connection with these transactions and make these records available to the Commission upon request. Rule 15a-6(a)(3)(iii)(A)(4), (E), 54 Fed. Reg. 30,031 (1989) (to be codified at 17 C.F.R. § 240.15a-6(a)(3)(iii)(A)(4), (E)). The rule also requires that foreign broker-dealers provide the Commission with information, documents, or records in its possession, the testimony of any of its foreign associated persons, and assistance in taking the evidence of other persons that relate to transactions with the United States institutional investor or the United States broker-dealer that executes them. Adopting Release, *supra* note 3, at 80,255.

31. Adopting Release, *supra* note 3, at 80,256. *But see* art. III, § 27 of the NASD Rules of Fair Practice, NASD Manual (CCH) ¶ 2177, at 2109; NYSE rule 342.16, NYSE Guide (CCH) ¶ 2342, at 3586-87; NYSE rule 405, *id.* at 3696-97. *Cf.* Merrill Lynch, Pierce, Fenner & Smith, Inc., Exchange Act Release No. 19,070, [1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,258 (Sept. 21, 1982).

Government,[32] the foreign broker-dealer must furnish the Commission "information, or documents" within the possession, custody, or control of the foreign broker-dealer, testimony of foreign associated persons, and assistance in taking the evidence of other persons that the Commission requests and that relates to transactions effected through the registered broker-dealer.[33]

Foreign associated persons of the foreign broker-dealer[34] effecting

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32. Recently, memoranda of understanding ("MOUs") have been entered into between various foreign jurisdictions and the United States. These include the United Kingdom, Japan, Ontario, Quebec, British Columbia, Switzerland, the Netherlands, Turkey, and Italy. MOUs make assistance available in matters involving insider trading, market manipulation, and misrepresentations relating to market transactions, as well as efforts relating to the oversight of the operation and financial qualifications.

H.R. 1396, The International Securities Enforcement Cooperation Act of 1989, which was passed by the House of Representatives on September 25, 1989, would facilitate further and more extensive MOUs. Among other things, the bill would:

> Exempt confidential documents received from foreign authorities from disclosure requirements under the Freedom of Information Act or other laws under certain conditions;
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> Make explicit the Commission's rulemaking authority to provide nonpublic documents and other information to domestic and foreign law enforcement officials;
>
> Grant the Commission and the self-regulatory organizations explicit authority to bar, suspend, or place limitations on securities professionals based upon the findings of a foreign court or foreign securities authority that such persons committed specified types of violations; . . . and
>
> Authorize the Commission to accept reimbursement for expenses incurred in providing assistance to foreign government authorities in their investigations.

H.R. REP. No. 240, 101st Cong., 1st Sess. 2 (1989).

33. Rule 15a-6(a)(3)(i)(B), 54 Fed. Reg. 30,031 (1989) (to be codified at 17 C.F.R. § 240.15a-6(a)(3)(i)(B)). These requirements are subject to an exception for information, documents, testimony, or assistance withheld in compliance with foreign blocking statutes or secrecy laws. The Commission may, however, withdraw the direct contact exemption with respect to subsequent activities of the foreign broker-dealer, or a class thereof, whose home country's law or regulations prohibited the foreign broker-dealer from responding to the SEC's requests for information, documents, testimony, or other assistance under paragraph (a)(3)(i)(B). This ability should enable the SEC to bring to bear considerable pressure on the foreign broker-dealer, though the exemption could only be removed prospectively.

34. Section 3(a)(18) of the Exchange Act defines "person associated with a broker or dealer" as:

> any partner, officer, director, or branch manager of such broker or dealer (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling, controlled by, or under common control with such broker or dealer, or any employee of such broker or dealer . . . whose functions are [not] solely clerical or ministerial . . . .

15 U.S.C. § 78c(a)(18) (1988). Foreign associated persons cannot be subject to a statutory disqualification specified in section 3(a)(39) of the Exchange Act, or:

> any substantially equivalent foreign (i) expulsion or suspension from membership, (ii) bar or suspension from association, (iii) denial of trading privileges, (iv) order

transactions with United States institutional investors or major United States institutional investors must conduct all their securities activities from outside the United States. Nonetheless, a foreign associated person may conduct visits to institutional investors within the United States if the foreign associated person is accompanied on these visits by an associated person of the registered broker-dealer that accepts responsibility for the foreign associated person's communications with these investors.[35]

C. Other Customers

The rule also exempts foreign broker-dealers that effect any transactions in securities with or for, or induce or attempt to induce the purchase or sale of any securities by the following: (1) a broker-dealer registered under section 15(b) of the Exchange Act;[36] (2) certain international organizations and their agencies, affiliates, and pension funds;[37] (3) any foreign person temporarily present in the United States with whom the foreign broker-dealer had a bona fide, pre-existing relationship before the foreign person entered the United States;[38] (4) agencies or branches of United States persons located outside the United States and operated for valid business reasons;[39] or (5) non-resident United States citizens.[40]

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denying, suspending, or revoking registration or barring or suspending association, or (v) finding with respect to causing any such effective foreign suspension, expulsion, or order; [can]not have been convicted of any foreign offense, enjoined from any foreign act, conduct, or practice, or found to have committed any foreign act substantially equivalent to any of those listed in section 15(b)(4)(B), (C), (D), or (E) of the Exchange Act; and [can]not have been found to have made or caused to be made any false foreign statement or omission substantially equivalent to any of those listed in section 3(a)(39)(E) of the Exchange Act.

Adopting Release, *supra* note 3, at 80,254 (footnote omitted).

35. Rule 15a-6(a)(3)(ii)(A)(1), 54 Fed. Reg. 30,031 (1989) (to be codified at 17 C.F.R. § 240.15a-6(a)(3)(ii)(A)(1)); *see* Adopting Release, *supra* note 3, at 80,254.

36. Rule 15a-6(a)(4)(i), 54 Fed. Reg. 30,031 (1989) (to be codified at 17 C.F.R. § 240.15a-6(a)(4)(i)).

37. Rule 15a-6(a)(4)(ii), 54 Fed. Reg. 30,031 (1989) (to be codified at 17 C.F.R. § 240.15a-6(a)(4)(ii)). These are the same international organizations specified in proposed Regulation S, Securities Exchange Act Release No. 6779, [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,242 (June 10, 1988).

38. Rule 15a-6(a)(4)(iii), 54 Fed. Reg. 30,031 (1989) (to be codified at 17 C.F.R. § 240.15a-6(a)(4)(iii)).

39. Rule 15a-6(a)(4)(iv), 54 Fed. Reg. 30,031 (1989) (to be codified at 17 C.F.R. § 240.15a-6(a)(4)(iv)).

40. Rule 15a-6(a)(4)(v), 54 Fed. Reg. 30,031 (1989) (to be codified at 17 C.F.R. § 240.15a-6 (a)(4)(v)). The staff generally had not required foreign broker-dealers to register

D. Market Making

While registration is required if market-makers' activities result in substantial United States contact or solicitation of United States investors,[41] registration is not required in the case of third-party systems that disseminate quotations but do not provide execution services in the United States.[42] The Commission encouraged interpretive relief for the distribution of foreign market makers' quotes by organized foreign exchanges in the absence of other inducements to trade by the foreign market makers.[43]

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when the foreign broker-dealer solicited United States persons abroad.

A foreign broker-dealer operating from outside the United States that solicits or engages in securities transactions with foreigners when they are temporarily present in this country need not register with the Commission provided the foreign broker-dealer had a bona fide pre-existing relationship with such persons before they entered the United States. Rule 15a-6(a)(4)(iii), 54 Fed. Reg. 30,031 (1989) (to be codified at 17 C.F.R. § 240.15a-6(a)(4)(iii)); *see* Adopting Release, *supra* note 3, at 80,258.

41. Adopting Release, *supra* note 3, at 80,239.

42. *Id.*

43. *Id.* The SEC staff has generally adopted liberal no-action positions with respect to foreign exchange quotations distributed in this country. *See, e.g.*, National Association of Securities Dealers, SEC No-Action Letter (May 7, 1986) (LEXIS, Fedsec library, Noact file); NASD/ISE, SEC No-Action Letter (Aug. 2, 1986) (LEXIS, Fedsec library, Noact file). These generally involved situations where recipients of the quotations were primarily United States registered broker-dealers, and the staff emphasized that activities resulting in substantial United States contacts or solicitation beyond passive market-making were outside the scope of the no-action positions.

The staff, by order, also exempted from registration several related foreign broker-dealers, despite their acting to some degree as dealers in the United States. Vickers da Costa (Aug. 18, 1986) (LEXIS, Fedsec library, Noact file). Non-registered foreign broker-dealers owned by Citicorp, a United States bank holding company, were thus permitted to buy and sell simultaneously on a continuing basis through a registered United States broker-dealer affiliate and active market maker in NASDAQ. The foreign broker-dealers' control over the price and size of standing orders was limited so that the United States affiliate had an ambit of discretion in its trading activities. Nonetheless, the United States affiliate was limited to executing, on a riskless principal basis, any orders received from United States customers against these orders. These restrictions were imposed in large part in order to address Glass-Steagall restrictions. *See* 12 U.S.C. §§ 24, 378 (1988). The foreign securities subsidiaries would not engage in other securities activities in the United States. United States customers who are parties to transactions between the American affiliate and the foreign affiliates would be customers of the American affiliate. The American affiliate would provide the Commission, on request, with information regarding trading activities of the foreign affiliates. Citibank agreed to satisfy additional net capital requirements intended to increase its ability to meet its settlement obligations in the event of the foreign broker-dealers' failure, and Citicorp agreed that it would be designated as the foreign broker-dealers' agent for service of process.

IV. FOREIGN REGULATION

Rule 15a-6 attempts to reconcile the goal of maintaining core protections for United States investors with facilitating access to international markets by United States institutional investors.

Although the Commission has a manifest interest in ensuring that basic protections are afforded United States participants in global markets, comparable safeguards may, in some instances, be provided by foreign regulators.[44] As reflected in the Concept Release, the Commission is considering substitute regulation by foreign securities authorities, especially when the foreign broker-dealer's United States customers are limited to sophisticated institutional investors.

If regulation of security professionals in their foreign jurisdiction is satisfactory, the Commission should recognize this mode as an acceptable proxy for its own broker-dealer regulation.[45] Once the Commission determines the suitability of another country's regulatory scheme, United States institutional investors buying and selling securities in that country's market should be able to deal with local broker-dealers in reliance upon the protections provided by the laws of that country.[46] Thus, smaller foreign broker-dealers, who cannot otherwise afford the expense of a United States affiliate, would be permitted to interact with United States institutional investors wishing to invest in foreign markets.

V. CONCEPT RELEASE

In the Concept Release, the Commission put forth, for comment, the idea of a conditional exemption from Commission registration for foreign broker-dealers. This would be accomplished by recognizing foreign regulation that would maintain minimum standards of competence, credit,

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44. The Commission acknowledged in the Proposing Release that "comprehensive regulatory schemes in other countries suggest the possibility that in the future some form of reciprocal recognition for broker-dealers could be agreed upon with foreign securities regulators." Proposing Release, *supra* note 3, at 89,198. It stopped short of any deference to foreign regulation, expressing concerns about reduced United States investor protection. *Id.*

45. *See, e.g.*, United Kingdom's Financial Services Act, 1986, ch. 60; Miller, *Regulation of Financial Services in the United Kingdom--An American Perspective*, 44 BUS. LAW. 323 (1989).

46. The Commodity Future Trading Commission ("CFTC") has adopted a similar approach governing foreign futures commission merchants. 17 C.F.R. § 30.10 & app. A (1989). The United Kingdom has created an analogous exemption. Financial Services Act, 1986, § 31; *see also* Miller, *supra* note 45, at 364; Proposing Release, *supra* note 3, at 89,198 n.66.

and fair dealing, without compromising existing protections of United States investors in United States markets.[47] The exemption would be limited to broker-dealers: (1) who operate outside the United States; (2) whose business is predominantly foreign;[48] (3) who do not have United States broker-dealer affiliates;[49] and (4) who limit activities requiring United States broker-dealer registration to providing cross-border services to major United States institutional investors.[50] Any exemption would require a finding of an applicable foreign regulatory scheme, comparable to that administered by the Commission, and a suitable memorandum of understanding or treaty between the Commission and the foreign securities authority, with respect to investigative and financial matters.[51] Foreign broker-dealers would have to comply with certain regulatory requirements deemed necessary by the Commission for investor and market protection.

Memoranda of understanding or comparable treaties must be entered into between the Commission and the foreign securities authority.[52] Since the foreign regulator will be the primary enforcer of the regulatory scheme, such a commitment is deemed essential by the Commission. Under these agreements, the foreign jurisdiction must consent to cooperate in both regulatory and enforcement matters.[53] The memorandum of

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47. The exemption would be adopted under section 15(a)(2) of the Exchange Act. Concept Release, *supra* note 4, at 80,261 n.7.

48. Any foreign broker-dealer who derives more than ten percent of its securities business from United States institutional investors would be excluded. Concept Release, *supra* note 4, at 80,262-63. The Commission expressed concern that disparities between the United States and a "comparable" scheme might encourage the United States broker-dealers to move offshore. *Id.* The Commission solicited comments about whether a dollar limit should also be imposed on broker-dealers. *Id.* at 80,262-63 n.11.

49. *Id.* at 80,262-63.

50. The Concept Release contemplates the possibility of a definition that differs from that of rule 15a-6(b)(4). *Id.* at 80,263 n.12.

51. An associate director of the Justice Department's Office of International Affairs is quoted as saying:

> In this day and age, with the internationalization of securities transactions, any country that wants to be a financial center is going to have a tremendous interest in some kind of arrangement [with the United States], because that's part of the quid pro quo. If you want to deal in [United States] securities or be part of the [United States] securities market, it comes with a cost.

Levin, *Global Greed*, 55 INVESTMENT DEALER'S DIG., No. 33, at 13 & 18 (Aug. 21, 1989).

52. Foreign securities authority is defined as "any foreign government, or any governmental body or regulatory organization empowered by a foreign government to administer or enforce its laws as they relate to securities matters." Exchange Act § 3(a)(50), 15 U.S.C. § 78c(a)(50) (1988); *see* Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 101-704, 1988 U.S. CODE CONG. & ADMIN. NEWS. (102 Stat.) 4677 (codified at 17 U.S.C. § 78c(a)(50)).

53. The exemption would not depend on a foreign country providing reciprocal treatment to United States broker-dealers. Concept Release, *supra* note 4, at 80,262.

understanding must provide full assistance in investigatory matters, litigation, access to records and reports, and disciplinary proceedings. It would also have to cover any self-regulatory organization sharing securities regulatory responsibility.

The foreign regulatory system must be analogous, although not identical, to the United States system.[54] The Commission deems essential the following elements:

1. Registration qualifications and conduct standards.[55]
2. Financial responsibility requirements and procedures for the protection of customer funds and securities.[56]
3. Credit limitations.[57]
4. A clearance, settlement, and payment system sufficient to accommodate the volume of transactions.[58]
5. Monitoring and enforcement of compliance with regulatory requirements.[59]

Finally, a United States regulatory system equipped to monitor this approach must be established.[60] In order to maintain eligibility for the exemption, the foreign broker-dealer *and* the foreign securities authority would have to remain in compliance with the specified conditions.[61] Moreover, the foreign firm must consent to service of process and agree to periodic certification of compliance and to provide records and information.[62] The general anti-fraud provisions of the securities laws would, of course, apply to United States activities of the foreign broker-dealer,[63] and the Commission would subject foreign broker-dealers and associated persons to disciplinary proceedings under sections 15(b)(4)

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54. The Commission recognized that "different cultures and market characteristics can result in alternative regulatory requirements appropriate for the particular jurisdiction" and, accordingly, that the foreign regulatory scheme should be assessed as a whole. *Id.* at 80,264.

55. *Id.* at 80,265.

56. Included in such requirements are considerations of the status of customer funds and securities when the foreign broker-dealer is adjudged a bankrupt and requirements of minimum capital. If such minimal capital requirements do not exist, the Commission suggests the imposition of supplemental capital requirements which the foreign regulatory system must agree to monitor. *Id.*

57. *Id.* at 80,266.

58. *Id.*

59. This should include record-keeping, reporting, surveillance, inspection, and disciplinary provisions. *Id.* at 80,266-67.

60. *Id.* at 80,267.

61. *Id.*

62. *Id.*

63. *Id.* at 80,268.

and 15(b)(6) of the Exchange Act.[64]

The Concept Release provides a provocative basis for further discussion. If foreign regulation is comparable to that of the United States, then interaction between the United States institutional investor and the foreign broker-dealer should be encouraged. After stating that principle, one must fill in the interstices with specific standards, for example, with respect to sound settlement and clearance systems and credit arrangements.

The Commission has sometimes been dogmatic about its own approach to regulation in domestic matters. For instance, as a regulatory technique, disclosure has been a shibboleth for the Commission, while banking regulators have assigned it lesser weight. The Commission should remain open to alternative approaches of foreign regulators, as opposed to insisting upon literal transplants of its own concepts.

The Commission acknowledges that United States registration requirements and standards may unduly restrict the access of the investors to unaffiliated broker-dealers.[65] The supplemental capital requirements discussed in the Concept Release, unfortunately, might preclude exactly those broker-dealers whom the Commission meant to embrace. This might occur despite the fact that one objective is access by United States institutional investors to smaller broker-dealers who cannot afford the additional expense of establishing a United States branch or United States affiliate.

An even more tolerant attitude should be adopted toward collateral matters. To illustrate, the Concept Release suggests similar regulations concerning a broker-dealer adjudged a bankrupt, the implication being that a statute such as the Securities Investor Protection Act ("SIPA") must exist in the foreign jurisdiction.[66] SIPA, however, was established to protect the "assets of small transaction customers" who are "unsophisticated participant[s] in a securities transaction."[67] The reciprocal-regulation concept, on the other hand, would apply to firms that deal with, for the most part, large and sophisticated investors. The United States institutional investor should generally be savvy enough to evaluate the merits and risks of an investment and have the ability to assume the economic risks. Perhaps more important, SIPA's coverage is limited, and the fact that institutions seldom leave their securities in custody with broker-dealers means that the protection of SIPA will rarely be meaningful to institutional investors.

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64. *Id.* at 80,267. Presumably such proceedings would involve only United States-related activities.

65. *Id.* at 80,261.

66. *Id.* at 80,266.

67. *See* SEC v. Ambassador Church Fin. Dev. Group, 679 F.2d 608, 614 (8th Cir. 1982).

VI. CONCLUSION

Notwithstanding these concerns, the Commission is to be commended for both its responsiveness in the rulemaking process that led to rule 15a-6 and its formal opening of a dialogue by means of the Concept Release. However modest the specifically contemplated steps, the Concept Release represents a bold initiative from a parochial scheme of regulation toward a more catholic global system.[68]

68. Former Chairman Ruder, addressing an annual meeting of the International Organization of Securities Commissions ("IOSCO") just prior to his leaving office, urged securities regulators to extend financial information-sharing agreements to affiliated broker-dealers operating in various jurisdictions and noted that IOSCO also is making great strides in developing global capital adequacy requirements. 21 Sec. Reg. & L. Rep. (BNA) 1438 (1989).