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By e-mail to: rule-comments@sec.gov

U. S. Securities and Exchange Commission
ATTN: Ms. Nancy M. Morris, Secretary
100 F. Street, N.E.
Washington, DC 20549-1090

Re: Exemption of Certain Foreign Brokers or Dealers
Release No. 34-58047; File No. S7-16-08 ("Proposing Release")

Ladies and Gentlemen:

We are a law firm primarily engaged in representing broker-dealers, securities industry professionals and investors, and we appreciate this opportunity to comment upon the Commission's proposed revision of Rule 15a-6. The views expressed in this letter are ours alone, and do not necessarily reflect those of our clients.

The proposed revision of SEC Rule 15a-6 contains welcome improvements, allowing expanded access by "qualified investors" (institutional and individual) to non-U.S. securities markets, reducing the costly, and often unnecessary functions of "chaperoning," and providing more realistic and cost-effective arrangements for recordkeeping. Nevertheless, we believe there are ways in which the Proposed Rule may be improved.

The following comments relate only to solicited transactions under 15a-6(a)(3).[1] We make no comment in this letter about Proposed Rule 15a-6(a)(1), exempting foreign brokers or dealers from U.S. broker-dealer registration when the transactions are unsolicited; nor about 15a-6(a)(2), governing research reports furnished to U.S. persons; nor about 15a-6(a)(4), governing special

[1] Unless otherwise indicated, all citations in the form "15a-6 . . ." refer to Proposed Rule 15a-6.

counterparty classes; nor about 15a-6(a)(5), governing certain U.S. activities of foreign options exchanges.

With respect to solicited transactions, Proposed Rule 15a-6(a)(3) offers two basic alternatives:

(A) Transactions that have been executed in a foreign jurisdiction, and then documented and cleared in the U.S. in accordance with U.S. securities regulations, and subject to U.S. investigative authority [15a-6(a)(3)(I) and (ii)]; and

(B) Transactions that have been executed in a foreign jurisdiction, and then cleared and documented in the foreign jurisdiction [Proposed Rule 15a-6(a)(3)(iii)(A)(1)], with responsibility for maintaining possession, custody and control of the customer's securities and cash either in the United States, or in the foreign jurisdiction, in accordance with foreign securities regulations [15a-6(a)(3)(iii)(A)], but requiring that the absence of U.S. protections be disclosed [15a-6(a)(3)(i)(D)] and that the foreign broker or dealer has consented to the jurisdiction of the Commission [15a-6(a)(3)(iii)(B)].

Narrowing the Range of Permissible "Foreign Regulation"

We urge the Commission to consider restricting the types and sources of foreign regulation that would satisfy these conditions and that would substitute for U.S. regulation.

Under Proposed Rule 15a-6(a)(3)(i)(D), brokers or dealers in foreign jurisdictions may operate in the U.S. without U.S. broker-dealer registration if, among other things, they disclose to U.S. investors that the investors will not be protected by U.S. segregation requirements (SEC Rule 15c3-3, etc.), by U.S. SIPC insurance, or by U.S. bankruptcy laws [15a-6(a)(3)(i)(D)(2)]. In effect, the foreign broker or dealer must disclose that the regulations of their home country will apply, and not those of the Commission [15a-6(a)(3)(i)(D)(1)].

But this disclosure provides no helpful information. Not all foreign regulation is the same, and the scope and limitations of the rules of many foreign jurisdictions will be unknown. Moreover, the large financial resources of a "qualified investor" would not necessarily empower the investor to obtain this information. Nor would it safeguard the investor from fraud. In fact, wealth might only qualify the investor as a more attractive target for fraud. In addition, the several methods provided by the Proposed Rule for alleviating this problem would fall far short of their goal:

First, subjecting foreign brokers or dealers to a requirement that they consent under Proposed Rule 15a-6(a)(3)(iii)(B) to a Commission or self-regulatory organization (SRO) enforcement proceeding would not meaningfully protect the qualified investor. The Proposed Rule does not (but should) additionally require that the foreign broker or dealer submit to United States civil jurisdiction. The Proposed Rule also does not (but should) contain provisions for the enforcement of any resulting judgment. Even in the United States, Commission and SRO monetary sanctions are often unenforceable. In distant lands, including some that have no treaties or mutual banking relationships with the United States, an order or judgement obtained by the SEC or an SRO would often be unavailing.

Second, the Proposed Rule requires a foreign broker or dealer to certify that its personnel have no criminal backgrounds or other statutory disqualifications [15a-6(a)(3)(i)(B)], that they have documented any regulatory enforcement actions against themselves [15a-6(a)(3)(i)(C)] and that a U.S. broker-dealer will maintain copies of these records [15a-6(a)(3)(iii)(C)]. These provisions afford U.S. investors no real protection. A foreign entity prepared to commit a major fraud against wealthy U.S. investors would hardly be deterred by fear that the Commission might criticize them for failing to document any criminal records of their personnel. In addition, many jurisdictions whose brokers or dealers could take advantage of these disclosure provisions lack systematic methods of collecting, preserving and accessing information of this kind, so there would be no way of determining the accuracy of their disclosures.

Third, the Proposing Release suggests that it would not allow an entity soliciting sales and selling securities in the United States to elect foreign regulation rather than U.S. regulation – an election that the Proposing Release calls "regulatory arbitrage." To prevent such "arbitrage," the Proposing Release defines the term "foreign broker or dealer" under 15a-6(b)(2) to be a broker or dealer having "at least 85% of the aggregate value of the securities [it] purchased or sold" be in foreign securities, as measured "on a rolling two-year basis." [15a-6(b)(2) and (3)]. The Proposed Rule contains no effective mechanism, however, to verify or enforce the foreign entity's compliance with this limitation until enforcement would be too late. Any foreign institution willing to defraud large numbers of U.S. investors would ignore this limitation, confident that any discovery of their violation would either be impossible or would be delayed long enough to permit them to complete their fraudulent scheme.

Finally, the Proposed Rule contains a "withdrawal of exemption" provision [15a-6(c)], but this provision is the reverse of what it should be. The foreign jurisdictions whose laws could substitute for U.S. laws in the protection of U.S. investors should not enjoy a presumption of regulatory adequacy. A disqualification for that purpose of foreign regulatory programs would usually happen

only after an adverse incident, and it would be of no consolation to a defrauded U.S. investor. Instead of a "withdrawal of exemption" – in the wake, perhaps, of a major fraud – the Proposed Rule should provide a condition precedent. It should consist of stated minimum criteria for the eligibility of a foreign nation's regulatory systems to form part of the basis for exempting their nationals from U.S. regulatory systems.

It would be practicable to apply such minimum qualification standards in advance. In fact, several foreign regulators have clearly established their bona fides as regulators, along with their commitment both to investor protection and the integrity of their own (and our) securities markets. Certain mechanical criteria of adequacy already exist. They include, for example, the membership of the foreign nation's regulatory authorities in the Intermarket Surveillance Group (to which FINRA, NYSE Regulation and other U.S. and foreign securities regulators belong, and whose regulatory programs are closely allied).

On the other hand, jurisdictions that have made no affirmative commitment to investor protection, or that possess no demonstrable antifraud or antimanipulative programs, should not be placed on equal regulatory footing with jurisdictions that possess mature regulatory systems. To grant U.S. solicitation privileges to firms operating under an uncontrolled securities regimen would expose U.S. "qualified investors" to the risk of foreign-directed frauds for which there would be no adequate deterrence or remedy. Indeed, the Proposed Rule would encourage such behavior.

Competitive Concerns

Under the Proposed Rule, U.S. brokers and dealers would be subject to more demanding compliance requirements in the United States than would their foreign competitors. The exacting requirements of custody-and-control, segregation, customer reserve, net capital, margin, recordkeeping and AML would all be waived for the foreign competitor operating under the Proposed Rule. For the competing U.S. brokerage firm, these rules would still apply.

At the same time, the Proposed Rule contains no requirement of reciprocity between the U.S. and the foreign jurisdictions whose brokers or dealers would operate freely in the United States. Many foreign jurisdictions currently prohibit U.S. broker-dealers from soliciting securities transactions in their countries, and those countries have no counterpart to Proposed Rule 15a-6. *See, for example*, the discussion in NASD Notice to Members 00-02 (January 2000) ("NASD Alerts Members to Their Obligations Concerning Soliciting Business in Foreign Jurisdictions"). Accordingly, the Commission should consider requiring substantial reciprocity in the treatment of

cross-border securities transactions by particular foreign jurisdictions before allowing their brokers and dealers to compete, on an unequal footing, with U.S. broker-dealers.

The Definition of "Effect"

The final comment of this letter concerns an issue of definition – a matter that may seem technical but is nonetheless vital to the Proposed Rule's structure and practical operation. That is the need to provide a definition of the term "effect."

"Effect" appears several times in the Proposed Rule, in 15a-6(a)(2), 15a-6(a)(3)(i)(B), 15a-6(a)(3)(ii) (where it appears twice), 15a-6(a)(4), 15a-6(a)(4)(vi)(A) and 15a-6(a)(5). The term does not appear to have, and probably should not have, the same meaning in each of these disparate contexts. Whether or not the same meaning is intended, the term should be defined. To leave it undefined is to risk unintended consequences.

There is only one commonly used definition of the term "effect," and it is that contained in the completely unrelated context of transactions initiated from the trading floor of a national securities exchange. That definition, in SEC Rule 11a2-2(T) ("the Effect vs. Execute Rule"), seems too broad for purposes of Proposed Rule 15a-6. In Rule 11a2-2(T)(b), we read that:

> For purposes of this section, a member "effects" a securities transaction when it performs any function in connection with the processing of that transaction, including, but not limited to, (1) transmission of an order for execution, (2) execution of the order, (3) clearance and settlement of the transaction, and (4) arranging for the performance of any such function.

In Proposed Rule 15a-6, however, the term "effect" seems intended to have a much narrower significance, that of "initiating, through solicitation or pursuant to a discretionary authorization." For example, Proposed Rule 15a-6(a)(3)(i)(B) establishes, as one of the conditions permitting a foreign broker-dealer to induce the purchase or sale of a security in the United States by a qualified investor, that the foreign broker-dealer "[d]etermine that the foreign associated person of the foreign broker or dealer *effecting* transactions with the qualified investor not be subject to one of the statutory disqualifications specified in section 3(a)(39) of the Act." (Emphasis added.)

But if the term "effect" is understood to include, as in SEC Rule 11a2-2(T), the "clearance and settlement of the transaction, and . . . arranging for the performance of any such function," Proposed Rule 15a-6 would require a foreign broker-dealer to police, not only the backgrounds of its own staff,

but also those of the personnel of any unaffiliated clearing organization involved in the ministerial functions of trade comparison and clearance. This would impose inappropriate – or at least unexpected – burdens and costs on foreign transactions, without commensurate benefits of investor protection.

On the other hand, Proposed Rule 15a-6(a)(3)(ii) authorizes a "foreign associated person" of a "foreign broker-dealer" to visit qualified investors within the United States, "provided that transactions in any securities discussed during visits by the foreign associated person with qualified investors are *effected* pursuant to paragraph (a)(3) ["Solicited Trades"] of this section . . . ." (Emphasis added.) In Proposed Rule 15a-6(a)(3)(ii), this usage of "effect" seems to cross-reference a section of the Proposed Rule on the comparison and clearance requirements for such transactions. Specifically, Proposed Rule 15a-6(a)(3)(iii)(A)(2)(ii) requires any registered U.S. broker-dealer involved in the transaction either to permit foreign clearance, while maintaining records of the foreign clearance, or to accept responsibility itself for, *inter alia,* "[r]eceiving, delivering and safeguarding funds and securities in connection with the transactions on behalf of the qualified investor in compliance with § 240.15c3-3 (the Commission's custody-and-control rule). In this context, the term "effect" does seem to imply a reference to <u>all</u> aspects of the resulting transaction, including clearance, custody and control. Hence, the term "effect" in the context of 15a-6(a)(3)(ii) seems to have a different meaning from its meaning in the context of Proposed Rule 15a-6(a)(3)(i)(B) (discussed above) . If the Proposed Rule intends that the term have the same meaning in both of these sections of the Proposed Rule, or in all sections of the Proposed Rule, that intent should be clearly stated in the Proposed Rule's definitional section, 15a-6(b).

Conclusion

We hope these comments will prove helpful, and we thank you again for the opportunity to suggest ways in which the Proposed Rule may better serve the interests of investor protection, competition and regulatory clarity.

Very truly yours,

BRUNELLE & HADJIKOW, P.C.

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