EU-US Coalition on Financial Regulation

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The Secretary
Securities & Exchange Commission
100 F Street, NE
Washington
DC 20549-1090

By email to: rules-comment@sec.gov

11 September 2008

Dear Sir

EU-US COALITION RESPONSE TO SEC PROPOSED AMENDMENTS TO RULE 15a-6 (FILE NO S7-16-08)

The EU – US Coalition on Financial Regulation (the "Coalition") is a broadly based group of financial trade associations in the United States, Canada and Europe[1], representing the bulk of major international institutions undertaking cross-border and trans-Atlantic securities business. The Coalition has been at the forefront of industry efforts to harmonise and facilitate cross-border activity in securities by firms in North America and Europe, and in March, the Coalition published its latest paper "Mutual Recognition, Exemptive Relief and 'Targeted' Rules' Standardisation: The Basis for Regulatory Modernisation", and shared this widely with SEC staff and other relevant regulatory and supervisory bodies in the US and the European Union.

The Coalition is pleased to be able to respond to the SEC's consultation.

General Remarks

The Coalition very much welcomes the SEC's proposal to amend Rule 15a-6. We believe that this will make a significant contribution to opening up markets on both sides of the Atlantic, in line with the increasing globalisation of securities business and will assist in reducing regulatory arbitrage and the cost for firms and their customers of doing business, while ensuring that continuing high standards of probity and conduct, and investor protection and confidence are maintained.

[1] The ABA Securities Association, the Bankers' Association for Finance and Trade, the British Bankers' Association, the Futures Industry Association, the Futures and Options Association, the International Capital Markets Association, the Investment Industry Association of Canada, the International Swaps and Derivatives Association, the London Investment Banking Association, the Securities Industry and Financial Markets Association, and the Swiss Bankers Association. The European Banking Federation is also an observer member of the Coalition and supports the contents of this letter as well. SIFMA, on the other hand, having made its own submission to the SEC, is not able to support this response where it can be distinguished from the text of that submission.

We particularly welcome:

(i) the expansion – in Rule 15a6(a)2 and (a)3 - in the range of persons which an unregistered broker-dealer may contact, including for the distribution of research reports, and the corresponding decrease in the qualifying thresholds from US $100mn in assets under management for a "major" or "institutional investor" to US $25mn for a "qualified investor";

(ii) the elimination of the "chaperoning" requirement in the current rule, thus enabling a broker-dealer from outside the US to offer all aspects of a transaction in foreign securities, provided it generally conducts "foreign" business as defined, and makes certain disclosures to investors; and

(iii) the codification of earlier staff no-action letters dealing with the treatment of US fiduciaries acting on behalf of foreign clients, and the ability of foreign options exchanges to familiarise US investors with their operations.

As a further general comment and as an adjunct to the proposal to amend Rule 15a-6, we also welcome the important work being undertaken by the SEC in establishing mutual recognition frameworks with overseas securities supervisors. We believe that such bilateral mutual recognition arrangements, including bilateral agreements between the US and the EU and individual Member States, Canada and Switzerland, could considerably increase investors' access to well-regulated transatlantic capital markets. Such arrangements will safeguard the common principles of investor protection and prudential supervision, while recognizing the characteristics of national regulatory, supervisory and enforcement frameworks as they have evolved over time and proven their worth. Consequently, we support moves by the SEC to agree frameworks for mutual recognition with relevant bodies such as the European Commission, and Canadian provincial securities supervisors

Areas of Consultation

The Coalition would like to make the following observations on the key aspects of the SEC's proposed rule change.

- Minimum asset level; we agree with the decrease in the threshold to US $25mn.
- Definition of "qualified investor": we understand that this definition will encompass "natural persons", and would welcome this where a US investor meets the threshold test (noting that it will apply to "foreign resident clients" in relation to fiduciary business).
- Chaperoning requirements: we welcome the alleviation of these requirements and agree with the proposed 180 day "visit" limitation.
- Distribution of research reports: we welcome the expansion from institutional investors to qualified investors
- Maintenance of books and records: pursuant to Exemption (A) (1), we welcome the ability to maintain these in a manner prescribed by a foreign securities authority, and this should apply, where relevant, to both the unregistered foreign broker-dealer, and the intermediating US registered broker-dealer. In respect of AML requirements, we believe that those are just as onerous in Europe and Canada as in the USA, as firms in these jurisdictions are obliged to abide by FATF guidance. We accept that the "reasonable determination" continues to be the appropriate standard for the disclosure of records.
- Disclosure of relevant regulator: we agree that the foreign broker-dealer should disclose this information and that relating to insolvency arrangements and the SIPA etc as appropriate, to US investors.

Further Comments

In terms of specific comments, the Coalition would make the following remarks, and where relevant, we believe that the following clarification would be useful:

Definition of foreign broker-dealers "regulated for conducting securities activities by a foreign securities authority" to conduct foreign business: In jurisdictions where an integrated financial services regulator exists, such as in the United Kingdom or Switzerland, and where all activities, whether banking, securities or other, are regulated by a single regulator, we believe that the Commission's rule changes poses no problem. This is because an institution receives permissions according to the type of activity it undertakes. In the rest of Europe and Canada, a number of regulators are unitary (stand alone securities, banking or insurance regulators) or the market model is one where a very broad range of permissible activities, including securities business, can be authorised by a unitary regulator. Typically this applies to the "universal banking model" in much of Continental Europe, which enables banks to undertake securities business. We would therefore appreciate confirmation that the definition of "regulated for conducting securities activities by a foreign securities authority" includes an authority which, strictly speaking, is a bank or other unitary regulator, though obviously has powers to regulate securities business.

Definition of "foreign business": we note that, in order to qualify for Exemption (A)(1), foreign broker-dealers will be subject to the requirement that they undertake at least 85% of the aggregate value of their transactional business in foreign securities, calculated on a rolling-two year basis. We appreciate that the justification for this new requirement is to avoid regulatory arbitrage in relation to US securities markets by limiting the quantum of business in US securities. We note, however, that no similar restriction, in terms of limiting the split between foreign and domestic securities business, applies to US broker-dealers undertaking business in European or Canadian markets.

We believe that the proposed foreign business test, however, is extremely complicated and burdensome to apply in practice and the time and expense entailed in this regard would be inordinately high. Moreover, we believe that the proposed test would give rise to innumerable questions as to whether specific types of instruments should be classified as "securities" versus "non-securities" under U.S. law and/or as "foreign securities" versus "U.S. securities", thus making extensive and ongoing interpretive guidance from the SEC imperative. Due to the complexity and expense entailed by ongoing compliance, the foreign business test could effectively deter many firms from using the first alternative.

We would suggest therefore that the foreign business test is greatly simplified. At least, the 60-day grace period given to foreign broker-dealers in the event of their falling below the threshold of 85% should be increased to 90 days

Definition of "foreign security": we note that the definition will encompass all equity and debt securities issued by a foreign private issuer, certain other securities issued or guaranteed by foreign governments, as well as debt securities issued by a US-incorporated issuer, where the distribution was effected outside the US, together with the allied derivative, but not swaps. The inclusion of other security-related products, such as options or indices depends on the nature of the product – usually its price or premium, but not their underlying value. As a result, we believe that this definition may materially under-estimate the full quantum of business being undertaken by a foreign broker-dealer, and therefore make it harder for them to meet an asset-based test.

We suggest that the SEC clarify that, for purposes of the test, it is only the transactions that result in a transference of economic or market risk that count towards the qualification of "foreign securities." This way the Rule would rightly - in our opinion - exclude repurchase transactions and securities lending transactions, thereby maximising the benefits of the proposed amendments for the interested parties

Regulation of Custody business: we note that under Exemption (A)(1), a foreign broker-dealer, subject to the foreign business test, will be able to be maintain full direct custody of funds and securities from resulting transactions, whereas under Exemption (A)(2), custody of funds will remain with a US-registered broker-dealer. The custody business is increasingly globalised and concentrated. The majority of global custodians are US-registered firms, with important activities in all major jurisdictions including Europe. The arrangement is mutually beneficial: these custody banks generate wealth and shareholder value for US investors, while providing employment worldwide. A major requirement of their business is to be able to service their clientele from a number of jurisdictions involving a wide range of securities, both domestic and foreign, wherever so located. So we wonder whether the distinction made in Exemption (A)(1) and (A)(2) is not in fact an artificial one, and one which might, moreover, inhibit the services offered by the foreign (in US terms) branch/majority-owned subsidiary of a US-incorporated global custodian or fiduciary agent offering services to US investors from another jurisdiction. The same might apply to custodians from Europe, wishing to offer an integrated (foreign and domestic securities) service to US investors.

Conclusion

We trust that these remarks are of assistance to you, and once again thank you for the opportunity of commenting.

If you require any further clarification of our comments, please contact Anthony Belchambers on +44 (0)20 7929 0090 (e-mail: belchambersa@foa.co.uk) or Alex Merriman who was the principal draftsman of this response on +44(0)20 7216 8901, or via e-mail to: alex.merriman@bba.org.uk.

Yours faithfully

Anthony Belchambers

For and on behalf of the EU-US Coalition Secretariat