Could/Should an Investment Adviser be a Broker-Dealer?[1]

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For non-U.S. investment managers, marketing their services and the securities of the private funds that they manage to U.S. resident investors raises issues and risks under the U.S. federal and state securities laws – in particular, the registration provisions of the Investment Advisers Act of 1940 and the Securities Exchange Act of 1934, respectively. Issues and risks also arise for domestic (U.S.-based) SEC registered investment advisers who co-manage assets with their non-U.S. counterparts and wish to receive orders from them to buy and sell securities for the clients with those co-managed assets, or from their own clients – or for the non-affiliated clients of those non-U.S. counterparts.

We discuss what constitutes brokerage under the U.S. federal securities laws in this context, recent SEC initiatives and enforcement actions related to this issue, proposes compliance tips and suggests some options by which the U.S. regulatory landscape could evolve to permit an investment adviser to engage in certain activities without having to register as a broker-dealer.

I. Setting the Scene

An Investment adviser located outside the United States ("non-U.S. Manager") wishing to access the U.S. markets will encounter a regulatory regime that is different in many ways from that in its home jurisdiction. In many countries, such a firm engages in asset management and brokerage (defined and discussed below) holds a single license from its regulator based on functional activity such as "arranging transactions in securities" or "providing investment advice." For such a non-U.S. Manager, providing a client with brokerage or self-directed

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accounts generally is deemed to be incidental to its main activities and does not require a separate registration.

For example, firms in Hong Kong obtain a Type 1 (dealing in securities), Type 4 (advising on securities) and Type 9 (asset management) license under one law, the HK Securities and Futures Ordinance, administered by a single regulator, the HK Securities and Futures Commission. In the United Kingdom, a firm registers with the UK Financial Conduct Authority ("FCA") to obtain a single license under the Financial Services and Markets Act 2000, as amended, and the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 to engage in multiple activities, e.g. dealing in investments as agent, arranging deals in investments and managing investments.[4]

By contrast, since primary securities and banking laws were enacted in the early 1930s to address the issues arising from the 1929 Wall Street crash and the Great Depression,[5] and continuing through the Credit Crisis that began in 2006, the U.S. regulatory regime separates the securities, banking, credit and insurance industries under the jurisdiction of multiple regulators and several laws. This allows for clarity in regulation but produces issues when a firm proposes to engage in activities covered by differing laws and regulators. One only needs to consider issues surrounding the implementation of a fiduciary duty rule,[6] swaps regulation and the challenges presented by bitcoins/cryptocurrency. A U.S.-based asset manager that is an investment adviser as defined in Section 202(a)(11)[7] of the Investment Advisers Act of 1940 ("Advisers Act") that is registered with the Securities and Exchange Commission ("SEC") is called an "RIA", an RIA provides discretionary or non-discretionary investment advice to its clients, regardless of their residence. However, this registration does not permit it to take

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[4] Separately, certain firms must also be licensed by the UK Prudential Regulatory Authority.
[5] See e.g. "The Credit Crisis and the Regulation of Hedge Funds: Two Roads Diverged?", Mark Berman, Chapter 14, "Hedge Funds and Prime Brokers" 2nd ed., © the editor and the named authors, Risk Books.
[6] See "SEC Proposes to Enhance Protections and Preserve Choice for Retail Investors in Their Relationships With Investment Professionals", Release 2018-68 (press release with links to proposals (Regulation Best Interest, RIA Interpretation and Form CRS Summary, April 18, 2018, www.sec.gov/news/press-release/2018-68.
[7] Subject to certain exclusions and exemptions, an "investment adviser" is defined as "any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities."

client orders to buy or sell securities or market the securities of Private Funds:[8] this may be done only by a broker-dealer registered with the SEC under the Securities Exchange Act of 1934 ("Exchange Act") – such a firm is called a "BD".

In the U.S. regime, a broker-dealer and an RIA are regulated under different statutes – broker-dealers under the Exchange Act and investment advisers under the Advisers Act, respectively. Each of these laws and the rules, regulations, exemptions, interpretations and no-action letters under them have differing purposes and approaches that have evolved and accumulated over the past several decades.

Absent an exception or an exemption, an entity wishing to engage in both types of activities requires two separate registrations:

- for its brokerage activities, register with the SEC as a broker-dealer and become a member of the Financial Industry Regulatory Authority, Inc. ("FINRA")[9] – it would then be known as a "broker-dealer" or "BD"; *and*
- for its investment advisory activities, register with the SEC under the Advisers Act as an investment adviser (once registered, referred to as an "RIA") or with a U.S. state regulator where a U.S. adviser has a smaller amount of AUM.

The Advisers Act provides an exception from the definition of "Investment Adviser" and, thus, from registration under that act for a broker-dealer that provides advisory services that are incidental to its brokerage services and where it does not charge an additional fee for such services. Doing more than this would subject such a BD to the registration provisions of the Advisers Act.

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[8] "Private Fund" refers to a non-U.S. hedge fund, private equity fund and other pooled investment vehicles that are excluded from the definition of "investment company" under the Investment Company Act of 1940 ("1940 Act") in reliance on exemptions provided under Sections 3(c)(1) or 3(c)(7) of the 1940 Act. *See* "Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management and Foreign Private Advisers", 76 Fed.Reg. 39,646 (6 July 2011), Advisers Act Release 3222 (22 June 2011), https://www.sec.gov/rules/final/2011/ia-3221fr.pdf ("Release 3222").
[9] Depending on where located and the type of customers or counterparties a BD has, registration with one or more U.S. states as a broker-dealer may be required. As an alternative to registration, an individual who is engaged in brokerage activities may associate themselves with a registered broker-dealer as a registered representative of that firm – a practice used by "private placement brokers".

However, neither the Advisers act nor the Exchange Act has a specific exemption to cover the opposite issue, namely, when is an investment adviser a broker.[10] Despite significant change in the industry (including the rise of the internet, social media, electronic communications and ever-developing practices such as robo-advisers and cross border activity – not to mention the rise of crypto-currencies and its challenges), the relevant law and SEC Staff pronouncements on brokerage and on this issue remain relatively unchanged since the 1990s and the SEC Staff has addressed the issue primarily by enforcement action.

This is a crucial issue. Often, a non-U.S. client of a non-U.S. Manager[11] will ask a firm to place orders to buy or sell securities. In many jurisdictions, the "single license" concept permits this. Because neither client nor firm is located in the United States, this does not involve the means of interstate commerce[12] so the Exchange Act BD registration provisions would not apply.

It is different when a U.S. person[13] is the client of a U.S. RIA or a non-U.S. Manager under the current U.S. regulatory regime. Specifically, issues under the BD registration requirements of Section 15 of the Exchange Act arise when such a firm goes beyond advisory services and:

1. holds itself out as being prepared or amenable to execute transactions in securities for a client or U.S. person;
2. takes an unsolicited order from a client or U.S. person to buy or sell securities and executes such transaction or routes it for execution; or
3. solicits a client or U.S. person to subscribe for the securities of a Private Fund.

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[10] Investment companies are exempt from the definition of "dealer" in the Advisers Act. In certain instances, a bank is exempt from being a broker, dealer or investment adviser and is generally exempt from SEC regulation via Regulation R.

[11] A non-U.S. Manager may or may not be engaged in business with U.S. persons or manage the assets of a Private Fund, be registered or exempt from registration under the Advisers Act or be an RIA.

[12] The "means of interstate commerce" include visits, the post, fax, e-mail, web site, social media and phone, text or instant messaging communications.

[13] The SEC and the SEC Staff use the definition of "U.S. person" in Rule 902 of Regulation S under the Securities Act of 1933, which is based on *residence*. Under this, a U.S. citizen residing in Rome would not be a U.S. person while a Dutch national residing in New York would. Note that the SEC and the SEC Staff have not defined the term "residence", which means that this is a "facts and circumstances" test to be a part of due diligence when opening an account and considered during the life of the RIA-client relationship. Note the use of the term "non-United States person" in the SEC release adopting amendments to Form ADV and certain Advisers act rules – see "Form ADV and Investment Advisers Act Rules", Advisers Act Release 4509, 81 Fed.Reg. 60417 (August 26, 2016).

These activities involve "brokerage" as this term defined in Section 3(a)(4) of the Exchange Act, and, absent an exemption or exception, subject that firm to the broker-dealer registration and regulation requirements of the Exchange Act. Doing this absent an exemption or exception and not registering would lead to an SEC enforcement action – and we note below cases involving this.[14]

As discussed below, in reliance upon no-action letters issued by the Staff of the SEC's Division of Trading & Markets ("TM", formerly Market Regulation) an RIA may effect transactions for its clients when exercising discretion and not have to register as a BD. However, nothing in the Advisers Act or the Exchange Act, the rules thereunder or SEC Staff pronouncements, permits an RIA, whether based in the United States or not, to solicit or receive from its U.S. clients orders buy or sell orders securities and execute or send them for execution.[15] Thus, a U.S.- or a non-U.S. Manager seeking to provide brokerage or self-directed accounts to a U.S. person and/or a solicit U.S. person to invest in Private Funds, absent registration as a broker-dealer, faces significant regulatory obstacles under the existing U.S. regulatory regime.

We provide an overview of the current regulatory framework a non-U.S. Manager encounters in the United States when attempting to offer advisory or broker-dealer services. We discuss current implications and risks for a U.S. and a non-U.S. Manager, compliance tips and we provide recommendations for potential regulatory reforms.

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[14] *See e.g. In the Matter of Bank Leumi le-Israel B.M., Leumi Private Bank, and Bank Leumi (Luxembourg) S.A.* Admin Proc 3-17631 (October 18, 2016) ("Bank Leumi").

[15] This is also the case for a U.S.-based RIA. SEC Staff no-action letters let such a firm do this when it exercises discretion for a discretionary client, only when such a firm does not solicit the client, does not have custody and does not send the client research. Soliciting a U.S. person to invest in a Private Fund and the provision of certain other services, when analysed under the definition of "broker" and the broad application of "solicitation" (discussed below), would subject such firm to BD registration.

II. Application of the Advisers Act

Registration

Depending upon the regulatory assets under management ("RAUM"), a U.S.-based firm must register with a state (under $100m RAUM) or the SEC (more than $100m RAUM) if it provides continuous and regular investment advisory services to its clients.

A non-U.S. Manager would not be subject to Advisers Act registration by remaining outside the U.S. markets and not engaging in any activity with a U.S. person that involves the means of interstate commerce.

Many non-U.S. Managers do opt to do business with U.S. persons. Typical marketing methods for a non-U.S. Manager include posting materials on its web site, sending e-mails or mail with informational materials, making telephone calls, sending faxes or making visits – each of which is a means of interstate commerce. When a U.S. resident prospect is sought, the means of interstate commerce are used and this implicates the U.S. federal (or state) securities laws. In limited instances, a non-U.S. Manager may engage others, "solicitors" under Advisers Act Rule 206(4)-3, to market its services.[16]

When through its own efforts or through the activities of a solicitor a non-U.S. entity has a prospect that wishes to become a client in a discretionary or non-discretionary (in "non-U.S. speak", non-discretionary is termed "advisory") relationship,[17] the non-U.S. Manager would be providing investment advice to a U.S. client using the means of interstate commerce. It must make a decision and choose one of these options:

- register with the SEC as an RIA;
- manage U.S. resident assets directly in a separately managed account (not in a Private

[16] Using finders or solicitors raises potential issues under both the Advisers Act and the Exchange Act, the discussion of which for purposes of the Advisers Act is beyond the scope of this article. *See William M. Stephens*, Admin Proc 3-15233 (March 8, 2013), http://www.sec.gov/litigation/admin/2013/34-69090.pdf; and *Ranieri Partners LLC and Donald W. Phillips*, Admin Proc 3-15234 (March 8, 2013), http://www.sec.gov/litigation/admin/2013/34-69091.pdf.

[17] In a discretionary relationship, the RIA or non-U.S. Manager has control of the client's assets and need not consult with the client to buy or sell. In a non-discretionary relationship, the RIA or non-U.S. Manager provides the client with research, advice or recommendations – it does not trade for its client and it does not take client orders to buy or sell securities.

Fund) as a Foreign Private Adviser;

- manage U.S. resident assets *solely* in a Private Fund as a Private Fund Adviser;
- become a "participating affiliate" to an affiliated RIA; or
- not accept the U.S. person as a client and avoid the U.S. markets altogether.

The first option for a non-U.S. Manager seeking to provide investment management services to a U.S. person is for the firm to register as an investment adviser with the SEC. Registration with the SEC under the Advisers Act means filing Form ADV Parts 1 and 2A with the SEC and complying with substantive requirements of the Advisers Act – and other relevant U.S. federal securities laws requirements.

A compliant RIA would be required to have the following.

1. Form ADV Part 1: basic information about you, with items such as AUM and disclosure of affiliates, related persons, activities and other factors.
2. Form ADV Part 2A: the narrative disclosure brochure that must be written in "Plain English".
3. Form ADV Part 2B: this is the brochure supplement with information about the individuals that will manage portfolios for U.S. clients and have contact with them.
4. Under Advisers Act Rule 206(4)-7, an RIA must have written policies and procedures ("WPPs") reasonably designed to prevent violations of the Advisers Act.[18]
5. Designate a chief compliance officer ("CCO"). Under an SEC interpretation, the CCO must be knowledgeable, competent and empowered to administer the compliance program.
6. A Code of Ethics compliant with Advisers Act Rule 204A-1.
7. Regulation S-P Privacy Statement, *if required*.

When the SEC adopted Rule 206(4)-7,[19] it made it clear that when an RIA developed its WPPs it must know its risks and conflicts: "[e]ach adviser, in designing its policies and procedures, should first identify conflicts and other compliance factors creating risk exposure for the firm and its clients in light of the firm's particular operations, and then design policies and

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[18] WPPs, usually contained in a Compliance Manual, include policies and procedures in key areas for investment management, books and records, advertising, preventing the misuse of inside information and non-public client information, cybersecurity, BCP and other topics.
[19] See "Compliance Programs of Investment Companies and Investment Advisers", Advisers Act Release 2204, 68 Fed.Reg. 74714 (December 24, 2003) ("Release 2204").

procedures that address those risks."[20]

The next two options are to seek to manage U.S. client money via an exemption from Advisers Act registration. The fourth option is to have the client become a client of an existing RIA and provide research, advice and recommendations to an existing RIA – not in a manner that would raise issues under Advisers act Section 208(d). The fifth option is obvious, but defeats the purpose of being able to do business with U.S. clients.

Exemptions

A non-U.S. Manager may be eligible for an exemption from Advisers Act registration. The two most commonly used exemptions are "Foreign Private Adviser" and "Private Fund Adviser".

The "Foreign Private Adviser" exemption contains five conditions (all must be satisfied), including having no place of business in the United States, having less than $25 million in regulatory assets under management ("RAUM")[21] attributable to not more than a combined total of 15 U.S. person clients and U.S. investors in the Private Funds it advises and not holding itself out[22] to the public in the United States as an investment adviser. No filing with the SEC is required to rely on the exemption for a Foreign Private Adviser, but a report on Form ADV is filed with the SEC, which results in the firm becoming an Exempt Reporting Adviser ("ERA").

[20] Release 2204 at 74716,

[21] SEC rules proscribe the method by which an adviser must calculate assets under management for purposes of SEC registration and exemptions. For more information on RAUM, *see* Berman, "Some tips on calculating RAUM" (April 2016), www.compliglobe.com/publications.

[22] A foreign private adviser will not be deemed to be holding itself out generally to the public in the United States *as an investment adviser* solely because it participated in a non-public offering in the United States of securities issued by a private fund pursuant to an exemption from registration under the Securities Act – but, it would be subject to broker-dealer registration. An adviser may be deemed to be holding itself out through a publicly available web site unless the web site includes a prominent disclaimer stating that the web site is not directed to U.S. persons, and the adviser implements procedures reasonably designed to guard against directing information about its advisory services to U.S. persons. For more information on the compliance and regulatory implications of this, please see "U.S. RIA and BD Roadmap" (June 11, 2018), www/CompliGlobe.com/publications.

The "Private Fund Adviser" exemption is for a firm that advises *only* Private Funds with less than $150 million in RAUM in the United States. A non-U.S. firm that managed assets solely from a location outside the United States would not be subject to this cap.[23]

While these exemptions allow a firm to avoid registration and substantive regulation and examination by the SEC, a firm relying on either of these is still subject to a subset of the Advisers Act rules and regulations.[24]

Participating Affiliates

A non-U.S. affiliate of an RIA, whether or not the RIA U.S.-based, may assist the RIA when it manages the assets of its U.S. clients. Such a firm must navigate the U.S. regulatory regime – and may be able to do so without itself becoming subject to Advisers Act registration. Here, a non-U.S. affiliate may provide its RIA affiliate with research, investment advice and recommendations for the RIA to use for its U.S. person clients. These affiliated sub-adviser firms are called, under a series of SEC Staff no-action letters,[25] "participating affiliates".

For the non-U.S. participating affiliate to avoid Advisers Act registration, the following conditions must be satisfied:

1. both must sign a participating affiliate agreement;
2. relevant personnel of the participating affiliate are "associated persons" and must comply with the RIA's Code of Ethics requirements for personal account dealing;
3. the participating affiliate must keep records of what it does for the RIA;
4. the SEC must have adequate access to trading and other records of the participating affiliate;

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[23] See Release 3222, note 11 *supra*.
[24] For example, a Foreign Private Adviser and a Private Funds Adviser is expected to adopt and comply with pay-to-play policies, in accordance with Advisers Act Rule 206(4)-5, and is subject to the general antifraud provisions of Advisers Act Section 206 including, in particular and where Private Funds are involved, Rule 206(4)-8.
[25] The five participating affiliate no-action letters are: *Mercury Asset Management plc* (April 6, 1993); *Kleinwort Benson Investment Management Limited, et al.* (December 15, 1993); *Murray Johnstone Holdings Limited, et al.* (October 7, 1994)*; ABN AMRO Bank N.V., et al.* (July 1, 1997); *and Royal Bank of Canada, et al.* (June 3, 1998). These no-action letters were confirmed by the SEC in Release 3222.

5. the participating affiliate must consent to service and make the associated persons and relevant books and records available for testimony; and
6. the RIA must disclose in its Form ADV (Part 2A) information about the associated persons.

The firms must establish *bona fide* affiliation through "control". Non-affiliated sub-advisers must conduct their own Advisers Act analysis with respect to registration or exemptions.

Similarly, one cannot "engineer" a participating affiliate relationship to avoid registration – this is doing indirectly what cannot be done directly under Advisers Act Section 208(d).

The RIA must exercise oversight over and supervise the participating affiliate in its role – failure to supervise is actionable under Advisers Act Section 203(e)(6).

An RIA may not engage in an activity that constitutes brokerage within the meaning of Exchange Act Section 3(a)(4) unless it is SEC registered as a BD – this would include, *inter alia*, taking orders to buy or sell securities from the associated persons of the participating affiliate. The participating affiliate no-action letters were issued by the Staff of the SEC's Division of Investment Management ("IM") pursuant to delegated authority under the Advisers Act. The no-action letters deal only with matters arising under Advisers Act Sections 203 and 208(d). Because these were issued by IM and not the Staff of TM, IM had no authority to pass on matters outside the Advisers Act – in particular, the Exchange Act and brokerage. This would have required action by TM and TM took no positon in these letters. Similarly, in Release 3222, the SEC, when it reaffirmed the concept of participating affiliates and discussed affiliated sub-advisers, did not address the issue of associated persons being able to exercise discretion over the client portfolios of the RIA or to pass orders to the RIA to buy or sell securities. Currently, any such activity would require the participating affiliate to undertake its own analysis to determine whether it should register as an RIA or a BD – engaging in this without such registrations could implicate Section 208(d) and lead to an examination or an enforcement referral – or possibly an enforcement action.

Parent-subsidiary relationships

Under the *Richard Ellis* no-action letter, a non-U.S. parent may provide research and share personnel with a U.S.-based subsidiary that reaches U.S. advisory clients. The entities involved must adhere to several conditions to demonstrate that they are, in fact, separate entities:

- the companies are separately organized, distinct entities;
- the registered adviser has personnel who are capable of providing investment advice;[26]
- all persons involved in the U.S. advisory activities (including providing research) are treated as "associated persons" of the registered adviser – they become ; and
- the unregistered entity must designate an agent for service of process and agree to make its employees involved in U.S. advisory activities and certain records (such as trading records) available to the SEC Staff.[27]

III. Application of the Broker-Dealer Registration Requirements

Generally, if a non-U.S. Manager offered only investment advisory services to a U.S. person and did not solicit or receive orders to buy or sell securities or solicit a U.S. person to buy or sell securities or invest in a Private Fund, or effect unsolicited orders from a U.S. client,[28] it likely would be beyond the reach of SEC broker-dealer registration and FINRA membership requirements.[29]

The risks come with engaging in any activity that is deemed to be brokerage under the Exchange Act and using the means of interstate commerce. As discussed below, under SEC Staff no-action letters, a firm that exercises discretion to place orders to buy or sell securities for a U.S. client is not deemed to be a broker and, hence, is not subjected to broker-dealer registration and regulation. Doing more raises broker-dealer registration issues.

Outside a discretionary relationship, a non-U.S. Manager that uses the means of interstate commerce to solicit and/or execute transactions in securities for its U.S. advisory clients, to offer self-directed accounts where clients place orders on an unsolicited basis for execution or

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[26] These personnel do not have to be located in the United States and do not have to be involved in all of the advice provided to U.S. persons. *See Uniao de Bancos de Brasileiros S.A*.
[27] The SEC expects these personnel and records to be made available to the extent necessary to monitor and police conduct that may harm U.S. clients or markets.
[28] *See* the discussion of the Rule 15a-6 FAQs, below.
[29] Regulation R permits U.S. banks to engage in certain securities activities without having to register with the SEC as a broker-dealer under the Exchange Act. It does not apply to non-U.S. banks. Due to the broad definition of the term "broker" and the SEC's position with respect to solicitations, it is conceivable that a non-U.S. bank that uses the means of interstate commerce to solicit U.S. persons to open a securities account or to engage in transactional business and is remunerated with transaction-based compensation would be a "broker" and, absent an exception or exemption, would have to register as a broker-dealer.

to solicit U.S. persons to buy the securities of a Private Fund would be engaged in an activity within the meaning of the term "broker" under Section 3(a)(4) of the Exchange Act. Absent an exemption or exception, they must register as a broker-dealer with the SEC and join FINRA. Similarly, a communication by a non-U.S. firm into the United States that is intended to induce a U.S. person to open a non-advisory securities account or buy or sell securities is a solicitation using the means of interstate commerce and implicates broker-dealer registration.[30]

Generally, the only exemptions available to a non-U.S. Manager are Exchange Act Rule 15a-6 (effecting transactions for certain classes of institutional investors) or Rule 3a4-1, the "issuer's exemption" (to sell securities in limited private placements).

While this paper posits a non-U.S. Manager engaging in a particular activity, the same analysis applies to a U.S.-based firm that would propose to take orders to buy or sell securities or solicit clients to buy the securities of a Private Fund – absent an exception or exemption it, too, must register as a broker-dealer.

IV. The Current U.S. Legal Framework for Broker-Dealer Registration

According to the SEC and the SEC Staff, the law in this area is clear and settled. The SEC and the SEC Staff have the final say. Those that "look for a route around" or an opinion that would open "new avenues" should heed the Bank Leumi *case and other SEC enforcement actions, but also the words of senior SEC Staff given at the 2016 and 2017 London SEC Conference, "SEC Regulation Outside the United States", "not to look for safe harbours where there are none" and that "[w]hen a non-U.S. firm enters the U.S. markets, it must play by the SEC's rules."*

The registration provisions of the Exchange Act apply to any person that engages in an activity that would bring it within the definitions of the terms "broker" or "dealer."

[30] *See, A Few Observations in the Private Fund Space*, David W. Blass, (former) Chief Counsel, Division of Trading & Markets, U.S. Securities and Exchange Commission (April 5, 2013) available at https://www.sec.gov/News/Speech/Detail/Speech/1365171515178.

What is a "Broker"?

A “broker” is defined in Exchange Act Section 3(a)(4) as a person engaged in the business of effecting transactions in securities for the account of others. A “dealer” is defined in Exchange Act Section 3(a)(5) as any person that buys or sells securities for its own account or for others.

Neither of these terms is defined in terms of jurisdictional limits. Using the means of interstate commerce, even once, is enough to confer jurisdiction to the SEC and for the SEC enforce the Exchange Act and the other U.S. federal securities laws.

To help determine whether a person is a broker, the SEC’s Division of Trading & Markets uses a "facts and circumstances" test in which it asks, among other questions:

- is the person engaged in the business of buying or selling securities?
- does the activity constitute effecting a transaction in securities for the account of others?
- does the person receive transaction-based compensation?

Historically, the factor that has been the most determinative, as cited in SEC Staff no-action letters and enforcement actions, is the receipt of transaction-based compensation.[31] Under this, the risk of being a broker *might* be minimal if, and only infrequently, a firm accepted an unsolicited order to buy or sell a security or accepted a subscription from a U.S. person for a Private Fund and did not receive transaction-based compensation.[32] This is a facts and circumstances issue and the opinion of counsel may be scrutinized and, possibly, not accepted by the SEC Staff.

[31] Transaction-based compensation may be (1) direct in the form of a commission or a turn on each leg of a riskless principal transaction or (2) indirect in the guise of a levy or fee calculated on the basis of a number of transactions contemplated by a client (or by any other means by which a firm receives remuneration or something of value in connection with a transaction in securities). *See*, *e.g.*, *Wolff Juall Investments, LLC* (May 17, 2005), citing *Birchtree Financial Services* (September 22, 1998), *1st Global* (May 7, 2001) and *Herbruck, Alder & Co* (May 3, 2002). *See also Blackstreet Capital Management LLC and Murray Gunty*, Admin Proc 3-17267 (June 1, 2016) (firm not SEC registered BD received transaction-based compensation in connection with the acquisition and disposition of portfolio companies.)
[32] See “Frequently Asked Questions Regarding Rule 15a-6 and Foreign Broker-Dealers” (updated April 14, 2014), https://www.sec.gov/divisions/marketreg/faq-15a-6-foreign-bd.htm (“Rule 15a-6 FAQs”).

Transaction-based compensation may be direct or indirect. An example of indirect transaction-based compensation would be factoring into a wrap fee or management fee a portion of that fee based upon an estimated number of transactions.

A firm might be a broker even if it did not receive transaction-based compensation. Whether a person engages in solicitation is also a key criterion in the evaluation.[33] Generally, under SEC Staff no-action letters, any promotional, introductory or marketing activity with respect to a security is "brokerage" and any person who engages in such activities may only do so in reliance upon an exemption or exception, or after becoming an SEC-registered broker. A non-U.S. person that uses the means of interstate commerce to solicit and effect transactions with or for a U.S. person in securities – such as the securities issued by the Private Fund that a non-U.S. Manager advises - would be deemed to be a “broker”. Registration would be required unless an exemption or exception is available.[34]

Application of the Definition of “Broker” to Investment Advisers

There are few SEC Staff no-action letters or SEC pronouncements that address the application of the Exchange Act broker-dealer registration provisions to an investment adviser.

Generally, under various SEC Staff no-action letters, an adviser that (i) transmits orders to buy or sell securities to a broker, dealer or bank for execution, (ii) does not provide custody and (iii) does not receive transaction-based compensation would not fall within the definition of “broker” and not be required to register as a broker-dealer.[35] Under, a firm may execute transactions for one or more U.S. clients in a discretionary investment management relationship free from Exchange Act registration. However, going beyond this limited set of activities by providing research and expecting an order from that, having custody,[36] soliciting

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[33] *See Oil-N-Gas, Inc*. (June 8, 2000) (relief denied on the grounds *inter alia* that the applicant targeted investors with direct mailings and follow-up email); *John R. Wirthlin* (January 19, 1999) (focus on activities of contacting prospects and afterwards explaining possible investment opportunities); and *Moneypaper*, (January 25, 1996) (no-action relief denied on *inter alia* engaging in widespread solicitation). *See e.g. SEC v. Century Investment Transfer Corp*., et al., Fed.Sec.L.Rep. (CCH) ¶ 93,232 (S.D.N.Y., October 5, 1971) (soliciting securities transactions evidence of “engaged in the business”).

[34] See Footnote 9 in Release 3222.

[35] *See*, *e.g.*, *In Touch Global LLC* (November 14, 1995).

[36] SEC Staff no-action letters that discuss this pre-date the December 2009 amendments to the Advisers Act custody rule, Rule 206(3)-2. This rule as amended provides that if an affiliate of the RIA has custody (as defined in the rule), the adviser is deemed to have custody. It might

the order (directly or indirectly) and providing brokerage and offering self-directed accounts would, absent an exemption or exception, require broker-dealer registration.[37]

The definition of broker uses the words "for the account *of others* [emphasis added]."[38] If an RIA and its non-U.S. participating affiliate co-managed the assets of the same client on a fully discretionary basis, might a "dual hatted" person (an associated person of the participating affiliate that is also an employee of the RIA and controlled and supervised by the RIA) with proper policies and procedures and books and records being generated send orders to the U.S. RIA for execution? Execution in a discretionary context is not deemed to require broker-dealer registration under relevant SEC Staff no-action letters, but, here, in this fact situation, the U.S. RIA would, if there was common control and supervision, policies and procedures, not be taking orders "from others" but from an associated person that it controlled and over its client's assets. Clearly, it could not pass along third-party orders. The participating affiliate letters do not by their terms address or permit this. However, from a policy standpoint, if a non-U.S. participating affiliate may give advice or recommendations to its RIA under the participating affiliate no-action letters, why should it not be able to pass-orders for execution for a client of the RIA or both affiliated firms? Where does a recommendation end and an order begin? Why not in this limited fact pattern "fuse" (read together) the "no brokerage" discretionary activities no-action letters with the participating affiliate no-action letters to further facilitate the global management of client assets in discretionary accounts?

Rule 3a4-1, the "Issuer's Exemption"

In addition to providing guidance on broker registration by issuing no-action letters and interpretations and addressing behavior outside the current regulatory framework by enforcement actions, in 1985 the SEC adopted Rule 3a4-1 under the Exchange Act that[39] provides a safe harbor exemption from broker registration under the 34 Act for "associated persons of issuers" who meet certain requirements. An "associated person" ~~is~~for purposes of the rule includes a partner/director, officer or employee of the issuer; a corporate general

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be asked whether an adviser having custody because a related person has custody would bring a non-U.S. Manager relying on these no-action letters under the aegis of broker-dealer registration.

[37] *See*, *e.g.*, *PRA Securities Advisers LP* (March 13, 993).

[38] Exchange Act Section 3(a)(4).

[39] "Persons Deemed Not To Be Brokers", Exchange Act Release 22172 (50 Fed.Reg. 27946), July 9, 1985).

partner of a limited partnership that is the issuer; or a company or partnership that controls, is controlled by or is under common control with the issuer. The exemption is available to an associated person of an issuer who is not currently associated with a broker-dealer, is not subject to a disqualification under the Exchange Act and is not paid commissions or other remuneration based either directly or indirectly on transactions in securities. The employee's sales activities must be limited to (i) certain types of transactions and specified institutional investors, (ii) clerical or ministerial activities or (iii) one offering a year. Thus, the rule could apply to the employees of a company under common control with the issuer, such as a general partner to a Private Fund organized as a limited partnership or limited liability partnership ("LP" or "LLP"), or those of the managing member to a Private Fund organized as a limited liability company ("LLC"). Employees of advisers that are not under common control with the issuer of the securities would not be within the group specified in Rule 3a4-1.

The Rule 3a4-1 safe harbor exemption is viewed by the securities bar as unavailable for advisers to private funds, especially continuously offered hedge funds, because, unless an employee is performing only clerical or ministerial functions or dealing only with certain institutions or in certain types of transactions, the employee looking to rely on the Rule's safe harbor is limited to one offering in any 12-month period. The SEC has made clear that participation in continuous, repeated or multiple sales would violate the once-a-year limit.[40]

There are policy reasons in favor of amending this rule or obtaining no-action relief from the SEC Staff to permit RIAs to engage in this activity, subject to conditions. Among them, the safeguards that RIAs provide to their clients are similar to those of BDs – the fact that an RIA is a fiduciary is an additional factor. So, too, is the fact that the markets have advanced to a point where an RIA to a Private Fund is in many instances not only a sponsor to such fund but is also, as is the case with non-U.S. Private Funds, involved with its operations. Lessons learned from the non-U.S. experience would help lay the groundwork for changes in the U.S. regulatory regime to harmonize non-U.S. and U.S. practices – achieving "the right kind of regulation".

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[40] Securities Exchange Act Release No. 22172 at Part II.D. It might also result in a finding that the person involved is engaged regularly in solicitations or might even bring the issuer fund into a "distribution" under Exchange Act Regulation M.

Even if the associated person of the issuing fund may be determined not to meet all the specific requirements of Rule 3a4-1, the provisions of Rule 3a4-1 remain instructive in evaluating the activities of associated persons in connection with their status under the Exchange Act. Moreover, with the rule as a starting point and guidance found in the no-action letters, a firm seeking to operate outside the scope of the Exchange Act could structure its activities and the role of its employees and associated persons to make the best possible argument to prevent employees from being engaged in the business of effecting transactions in securities. Such actions should include not paying employees and associated persons transaction based compensation and making sure such persons are engaged in other activities for the firm besides solicitation of investors for the fund.

An Exemption from Broker-Dealer Registration: Exchange Act Rule 15a-6

Non-U.S. firms may use Rule 15a-6 to avoid registration with the SEC as a broker-dealer. Rule 15a-6 permits certain U.S. Institutional Investors to access foreign markets, research and securities through non-U.S. firms. Under Rule 15a-6, a non-U.S. firm can, without registration:

- effect unsolicited transactions in securities with U.S. persons;
- subject to certain conditions, solicit "Major U.S. Institutional Investors"[41] by furnishing them directly with research reports;
- solicit transactions in securities from and execute transactions with or for Major U.S. Institutional Investors or "U.S. Institutional Investors",[42] subject to conditions; or
- solicit/execute transactions directly with SEC-registered broker-dealers (acting as principal or agent), banks acting in a broker-dealer capacity (that are exempt from being a BD, international entities, non-U.S. persons temporarily in the United States with which the non-U.S. firm has a pre-existing relationship, non-U.S. agencies or branches of U.S. persons permanently outside the United States (trades must occur outside the United

[41] A "major U.S. Institutional Investor" is any entity that owns, controls, or has under management more than $100m in aggregate financial assets.

[42] A "U.S. Institutional Investor" is: an SEC registered investment company; a bank, savings and loan association, insurance company, business development company, small business investment company or employee benefit plan defined in Securities Act Regulation D Rule 501(a)(1); a private business development company defined in Rule 501(a)(2) of Regulation D; an organization described in Section 501(c)(3) of the U.S. Internal Revenue Code of 1986; or a trust defined in Rule 501(a)(7) of Regulation D.

States) and groups of U.S. citizens residing outside the United States (there is a ban on direct selling efforts toward them).

The SEC defines the term "solicitation" for purposes of Rule 15a-6 as any affirmative effort by a non-U.S. firm that induces or is intended to induce transactional business or develop an ongoing relationship for that non-U.S. firm or for its affiliates.[43] Under Rule 15a-6, a non-U.S. firm, including a non-U.S. Manager, may induce or attempt to induce transactions in securities with a Major U.S. Institutional Investor. In this regard, the SEC stated in the 1989 release adopting Rule 15a-6 that "a foreign broker-dealer [may] contact a [Major U.S. Institutional Investor] without the participation of an associated person of a registered broker-dealer in any of these contacts",[44] which would include a phone call, a fax, an e-mail, post and a visit -- presumably, this would include, but with appropriate safeguards and controls, web sites and e-mails (not in existence when this rule was adopted but would fall under this). Transactions would have to be intermediated by a broker-dealer.

Rule 15a-6 sets conditions for transactions with a "U.S. Institutional Investor":

- contacts with U.S. Institutional Investors must be "chaperoned" by a person associated with an SEC registered broker-dealer (there are third-party U.S. brokers that specialize in providing access to U.S. investors in compliance with the rule) – information or documents relating to transactions carried out under Rule 15a-6 would have to be provided to the SEC upon request;
- the registered broker-dealer must take supervisory responsibility for the transactions and the non-U.S. firm's activities; and
- the non-U.S. firm cannot be subject to a statutory disqualification.[45]

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[43] The term "solicitation" is not rule-defined but was articulated in the release adopting Rule 15a-6, a safe harbor from broker-dealer registration and, since then, has been restated in no-action letters and other SEC pronouncements. *See Registration Requirements of Foreign Broker-Dealers*, 54 Fed.Reg. 30013 (18 July 1989), Exchange Act Release 27017 ("Rule 15a-6 Adopting Release").

[44] Rule 15a-6 Adopting Release, 54 Fed.Reg. 30017 at 20024.

[45] *See, e.g.,* Letter from Catherine McGuire, Chief Counsel, Division of Market Regulations, SEC, to Giovanni P. Prezioso, Esq., Cleary, Gottlieb, Steen & Hamilton (January 30, 1996); and Letter from Richard R. Lindsey, Director, Division of Market Regulation, SEC, to Giovanni P. Prezioso, Esq., Cleary, Gottlieb, Steen & Hamilton (9 April 1997).

Rule 15a-6 and the SEC Staff no-action letters issued under this rule address brokerage and trading – they do not reflect or apply to selling securities during an offering of securities – IPO, secondary or continuous offering of the securities of a Private Fund. In theory, it is possible, in compliance with Rule 15a-6, for a non-U.S. Manager to solicit a Major U.S. Institutional Investor or a U.S. Institutional Investor to buy and sell in an offering non-U.S. securities, including Private Funds. However, based on the guidance in no-action letters issued under Rule 15a-6, such a transaction would have to be "intermediated" by an SEC registered broker-dealer – receiving funds and issuing a contract note (confirmation under Exchange Act Rule 10b-10). While valid in the pre-internet days and in the early years of Rule 15a-6, the internet, globalization and electronic trading advances have made intermediation not only redundant but, in many instances, a burden.

For all other U.S. persons or where Rule 15a-6 is not available, an SEC-registered broker-dealer must be used, particularly to intermediate the transaction. Not using Rule 15a-6 or intermediating through an SEC registered broker-dealer raises the spectre of engaging in an activity that would attract regulatory scrutiny and require Exchange Act registration or, in certain instances, possibly an enforcement action.

Noting the significant level of broker regulation and enforcement in other jurisdictions and cross border information sharing and enforcement protocols, appropriate controls could be implemented to provide safeguards to ease the way away from intermediation.

V. What This Means for a Non-U.S. Manager

The *primary* business of investment advisers – whether non-U.S. Manager or U.S.-based RIA – is to manage assets on a discretionary basis or give investment advice. It is not to solicit investors for securities transactions, hold themselves out publicly as being engaged in the business of buying or selling securities, solicit Private Fund subscriptions or take unsolicited orders to buy or sell securities. If they engaged in these activities, applying the elements of the facts and circumstances test used to define a "broker" under Exchange Act Section 3(a)(4) and going beyond Rule 15a-6 FAQ 9, it would stand to reason that, under current SEC and SEC Staff interpretations and the application of the Exchange Act, they would be brokers and, to continue to engage in such activity, should register.

Understandably, a non-U.S. Manager that wants to access the U.S. markets typically does *not* wish to register as a broker-dealer. Brokerage is ancillary to its primary activities and, under the regulatory systems in which they operate, does not require separate or special registration. The choices facing an RIA that wishes to take client orders to buy or sell securities or to sell the securities of the Private Fund they advise are: (1) register as an RIA and try to organize its activities to be as close as possible to the requirements of Rule 3a4-1 to achieve this exemption from broker-dealer registration; (2) register as a broker-dealer; (3) register as both a broker-dealer *and* an RIA; or (4) do not engage in this activity.

These issues are exacerbated by other factors, including differences in key definitional terms in the U.S. federal securities laws used in private placements, exemptions from the definition of an investment company and exemptions from broker-dealer registration. For example, the definitional requirements for individuals for private placements under Regulation D under the Securities Act, "Accredited Investors"[46] and the 1940 Act, "Qualified Purchasers,"[47] are not the same. Also, the definitions of Qualified Institutional Buyer ("QIB") under Rule 144A and "Major U.S. Institutional Investor" in Exchange Act Rule 15a-6 also differ. These definitional differences present issues for distributors of the securities of non-U.S. funds and hedge funds because, for example, it means that institutional investors may be solicited in reliance on a provision of Rule 15a-6 while individuals may not be, or certain institutional investors would be a Qualified Purchaser not a QIB or a Major U.S. Institutional Investor.[48]

These different definitions and the challenge of navigating multiple U.S. state and federal securities laws help explain why a non-U.S. Manager is not able, or willing, to solicit U.S. prospects. This is costly and time consuming, involves regulatory risks and often results in the non-U.S. Manager turning away U.S. prospects. There is a fear of an SEC examination or

[46] Section 413(a) of the Dodd-Frank Act amended the definition of "accredited investor" to exclude the value of the primary residence from the $1 million net worth calculation. The other provisions of the "accredited investor" definition, including the net income test for natural persons, remain unchanged. See SEC Staff "Report on the Review of the Definition of "Accredited Investor", December 18, 2015, www.sec.gov/corpfin/special-studies/review-definition-of-accredited-investor-12-18-2015.pdf.

[47] A "qualified purchaser" is defined in 1940 Act Section 2(a)(51) and, in relevant part, includes natural persons who own at least $5 million in "investments" (securities, real estate, commodities, financial contracts, cash and cash equivalents when held for an investment purpose) and institutional investors that own and invest on a discretionary basis at least $25 million in investments.

[48] A chart outlining these definitions is available upon request, from info@compliglobe.com.

enforcement action. A fall-back position for a non-U.S. Manager seeking U.S. persons to invest in the Private Funds that it manages and seeking to avoid broker-dealer registration would be to solicit Major U.S. Institutional Investors under Rule 15a-6 or use an SEC-registered broker-dealer to solicit U.S. Institutional Investors – or, for a general partner of an LP or LLP or a managing member of an LLC, to structure its activities to comply with Rule 3a4-1. The Private Fund would need to be exempt from being an investment company under the 1940 Act in reliance upon the Section 3(c)(7) exemption.[49] To go this route, the non-U.S. Manager would first categorize its U.S. prospect, not just as a Qualified Purchaser but as a Major U.S. Institutional Investor or a U.S. Institutional Investor. It would solicit Major U.S. Institutional Investor prospects and use an SEC-registered broker-dealer to solicit the U.S. Institutional Investor prospects. It could not, however, directly solicit HNWIs or persons that satisfied the Qualified Purchaser test but were not eligible under Rule 15a-6 – this is brokerage.[50] These prospects would have to be solicited directly by an SEC registered broker-dealer.

Application to Private Funds

The care that must be invested in this analysis takes on special meaning in light of a Commission statement in Release 3222 where the SEC adopted Dodd-Frank Act-mandated exemptions from Advisers Act registration. The statement was made in the context of commenting on the status of persons "who market interests in a private fund" under Section 15(a) of the Exchange Act. The Commission itself, not the Staff, noted that "[s]olicitation is one of the most relevant factors in determining whether a person is effecting transactions in securities for the account of others”.[51] Significantly, there is no reference in this statement to transaction-based compensation.

Some have suggested that this raises the question whether the SEC intended to use solicitation as *the* benchmark for measuring the role of the person(s) selling the securities of Private Funds with respect to Exchange Act registration requirements and to distinguish this from effecting transactions in securities apart from offering securities – particularly given that

[49] Section 3(c)(7) lets a Private Fund sell its shares in the United States on a private placement basis as long as every U.S. investor is a qualified purchaser. Generally, there is no limit in Section 3(c)(7) on the number of qualified purchasers. Non-U.S. Private Funds rarely use Section 3(c)(1).
[50] Release 3222, footnote 9.
[51] *Id*.

SEC Staff no-action letters address the latter activity. There are also the SEC enforcement actions cited below. It raises the issue whether the role of transaction-based compensation continues to be the key, or even, a, factor, in the test to determine who is a broker under Exchange Act Section 3(a)(4) for activities other than soliciting persons to buy the securities of Private Funds, including Rule 3a4-1. It focuses attention on activity and on persons that market the securities of Private Funds, particularly U.S.-based finders and solicitors.

Unsolicited Orders

A non-U.S. Manager is free to take orders to buy or sell securities from its non-U.S. clients. On occasion, a non-U.S. Manager may, as an accommodation to a U.S. client, wish to take and route for execution an unsolicited order to buy or sell securities. This would fall into the Rule 15a-6(a)(1) unsolicited transaction exemption. One is permissible, but how many more than one order may be taken? Doing, say, five or 10 a year may not appear problematic. Would this be five or 10 for one client, or, say, one each for five or even 10 clients? There is no public SEC or SEC Staff pronouncement showing where the line is drawn at how many transactions would constitute a level of solicitation requiring broker-dealer registration. Doing many would give rise to serious issues and invite SEC Staff scrutiny and possibly, if the conditions were egregious, an enforcement action. SEC enforcement actions are outlined below.

There is clarity in Question 9 in the Rule 15a-6 FAQs ("FAQ 9").[52] FAQ 9 treats when a few more than one unsolicited transaction exemption *for the same U.S. investor* would attract regulatory scrutiny. Paraphrasing FAQ 9, the SEC Staff stated that it would not ordinarily consider one transaction in compliance with Rule 15a-6(a)(1) as preventing more than one such transaction, but caveated this as being evident of a solicitation. Noting, the SEC Staff continued, that solicitation is broadly applied, it cited factors from the 1989 Adopting Release that would be solicitation:

- "Telephone calls from a broker-dealer to a customer encouraging use of the broker-dealer to effect transactions;
- Advertising directed into the U.S. of one's function as a broker or a market maker; and

[52] Rule 15a-6 FAQs.

- Recommending the purchase or sale of particular securities, with the anticipation that the customer will execute the recommended trade through the broker-dealer."[53]

Continuing, the SEC Staff said that "a series of frequent transactions or a significant number of transactions between a foreign broker-dealer and a U.S. investor as being indicative of solicitation through the establishment of an "ongoing securities business relationship."[54] Thus and because under the FAQs non-U.S. Managers cannot provide the protections that an SEC registered broker-dealer could, [55] engaging in a few more than one carries with it significant risks.

FAQ 9 deals with factors (what is a solicitation), not numbers (how many *bona fide* unsolicited transactions) that would constitute holding out or engaging in a solicitation and push a non-U.S. firm into broker-dealer registration territory. Apart from this, there is clarity in the law as regards what is a broker under Exchange Act Section 3(a)(4) and in certain SEC enforcement actions. So far, however, the cases brought by the SEC have involved large numbers of transactions, so the query is whether the SEC Staff would ever give a number. Presuming that the emphasis is and remains upon factors and not numbers, it is not likely that a number will be forthcoming unless cited in passing in an enforcement action.

FAQ 9 refers to "the same U.S. investor".[56] It does not address two or more U.S. investors. As such, a non-U.S. Manager would be advised not to try to apply FAQ 9 to more than one of its U.S. clients at the risk of being deemed to be an unregistered broker, outside Rule 15a-6(a)(1) and FAQ 9 and in violation of the Exchange Act's broker-dealer registration requirements.

Might a non-U.S. Manager claim that it was not a "foreign broker or dealer" as this term is used in Rule 15a-6 and occasionally take orders from U.S. clients? This term is defined in this rule as "any person not resident in the United States (including any U.S. person engaged in business as a broker or dealer entirely outside the United States, except as otherwise permitted by [Rule 15a-6] that is not an office or branch of, or a natural person associated with, a registered broker or dealer, whose securities activities, if conducted in the United

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[53] Rule 15a-6 FAQs, FAQ 9.
[54] *Id*.
[55] Rule 15a-6 FAQs, footnote 21 for FAQ 9.
[56] Rule 15a-6 FAQs, FAQ 9.

States, would be described by the definition of broker in section 3(a)(4)”.[57] Claiming that it was not a foreign broker or dealer would not preclude the applicability of Rule 15a-6. It is probably not relevant to consider whether the non-U.S. Manager was authorized to engage in the equivalent of brokerage in its home country. Noting that the definition of this term and Advisers Act Section 208(d) that makes it unlawful for an adviser to do indirectly what it could not do directly, and the use of the means of interstate commerce to take the order would place such firm squarely in the analysis for engaging in a course of conduct that was a solicitation and outside available SEC Staff no-action letters.

The Inadvertent Solicitation of Brokerage and Custody

Other issues can arise for a non-U.S. manager in connection with the inadvertent or indirect solicitation of brokerage, involving a non-U.S. custodian that operates trading desks where the non-U.S. Manager sends its orders (in the discretionary context) to buy or sell securities.

Under Advisers Act Rule 206(**4**)-2, custody is holding cash or securities and other investments for a client or having the authority to obtain possession of them.[58] An RIA has custody if a related person has custody. The “definition” of custody in many non-U.S. jurisdictions generally is similar. A custodian holds cash or securities, settles transactions, processes distributions, interest and dividend payments, manages proxy materials, tracks corporate actions and generally acts as a fiduciary in performing these roles.

In the life-cycle of a transaction, brokerage begins with the placing or receipt of an order to buy or sell securities and ends when the trade is executed and the contract note/confirmation is issued. Custody is not brokerage, nor is it investment management, and thus, on its own, does not require either Advisers Act or Exchange Act registration. Likewise, accepting instructions for a completed transaction in which the custodian played no role and then became involved in matching, clearing and settlement should not give rise to brokerage, as settlement is not brokerage. Custodians do not register with the SEC to engage in custody – this is a matter for banks and trust companies under other U.S. laws, rules and regulations. However, if a custodian did accept orders from a custodial client to buy or sell securities or

[57] Rule 15a-6(b)(3).

[58] Rule 206(4)-2. See, generally, Plaze, “Understanding the Investment Adviser Custody Rule: Parts I and II”, the Review of Securities & Commodities Regulation, Vol 48 No 6 (March 18, 2015) and Vol. 48 No 8 (April 22, 2015).

provides investment advice about securities for compensation, it would be subject to registration as a broker-dealer or RIA, respectively. Non-U.S. custodians, unless they are SEC-registered, may wish to avoid U.S. regulation. To achieve this, they should not promote their trade execution services to U.S. persons nor should they have others do this for them including, but not limited to, an affiliate or a branch or rep office in the United States.

It is not unusual for a U.S. client opening an account with a non-U.S. Manager to request information about a custodian, or a referral. If the non-U.S. Manager makes such a referral and the custodian does not execute transactions, no BD registration issues should arise.

If the non-U.S. Manager provides only discretionary investment management services, trades for its client within the proper exercise of discretion and the custodian only holds assets and does not effect client-initiated transactions (whether or not through the non-U.S. Manager), no Exchange Act broker-dealer registration issues should arise. It should make no difference whether the orders to buy or sell for the client go to an independent executing broker, an affiliate of the custodian (a separate legal entity) or a trading desk or group in the same entity but segregated from the custodial unit and where appropriate controls are implemented to keep trading and custody separated. (It is a conflict of interest if a non-U.S. Manager sends all of its orders to an affiliated broker or a related person who has custody under Rule 206(4)-2. Such controls would include sending the order to the trading desk and not the custodial unit, the use of appropriate physical or information barriers or placing orders via an electronic order routing system and where the custodial unit was not involved in any step of execution but became involved only in matching, clearing and settlement.)

An RIA should not solicit a U.S. prospect to open a discretionary investment account with it and promote or encourage the prospect to use a particular custodian because of the transaction execution capabilities of the custodian – this could be deemed the indirect solicitation of brokerage.

The brokerage issue is also present where the U.S. client has an advisory relationship with its non-U.S. Manager. While the non-U.S. Manager would not take client orders, its clients might wish to send an order to the custodian, particularly if this involved a non-U.S. security. This is brokerage and would subject the custodian to Exchange Act registration as a broker and possibly resulting in the non-U.S. Manager being considered to be an introducing broker. Such a result is harsh but, under current U.S. law, is the outcome, and stands in stark contrast when the same facts play out in a foreign jurisdiction where these activities would not require separate or special registration. Until the SEC or the SEC Staff takes a position on this issue, in rule-making or in an interpretation or no-action letter, it is prudent for a non-U.S. Manager and a custodian to avoid this altogether. This is particularly true if, going forward, the SEC places emphasis on solicitation in determining whether someone is acting as a broker-dealer beyond the solicitation of prospects to buy the securities of Private Funds.

Enforcement Risk

Getting it wrong has serious consequences. The SEC has sued non-U.S. persons that use the means of interstate commerce to solicit brokerage or sell the securities of non-U.S. Private Funds in the United States without registration or an exemption from registration.

- *In the Matter of CentreInvest, Inc., CentreInvest Securities, Vladimir Chekholko, William Herlyn, Dan Rapoport, and Svyatoslav Yenin.* [59] The SEC sued employees of a non-U.S. broker-dealer, its SEC-registered broker-dealer affiliate and four "associated individuals" for soliciting U.S. investors without complying with the Exchange Act broker-dealer registration provisions and not using Rule 15a-6, discussed below. Further violations involved the failure by the broker-dealer to keep books and records or produce same when requested. The first Rule 15a-6 case brought, it involved alleged *wilful* violations.

- *SEC v. UBS AG.* [60] The SEC sued UBS for, *inter alia*, soliciting U.S. persons to place orders with it to buy and sell securities and not being registered as a broker-dealer, and for providing investment advice and not being registered as an investment adviser. UBS consented to a final judgment that "(1) permanently enjoins UBS from further violation of those provisions; (2) orders it to pay $200 million in disgorgement, to be paid together with an additional $180 million in disgorgement that will be paid as part of a settlement of a related criminal investigation; and (3) orders UBS to comply with its undertakings to terminate its U.S. cross-border business and to retain an independent consultant to conduct an examination of UBS's termination of the business." [61] This was in addition to a deferred prosecution agreement with the Department of Justice in which UBS agreed to pay a further $180m in disgorgement and $400m in tax-related payments.

- *Banco Espirito Santo S.A.* [62] For five years, Banco Espirito Santo ("BES") offered brokerage and investment advice to approximately 3,800 U.S. residents who were primarily Portuguese immigrants. BES was not registered with the SEC as a BD or RIA. BES, sued for failure to register, agreed to pay nearly $7 million in disgorgement, prejudgment interest

[59] Exchange Act Release 34-59067, Administrative Proc. 3-13304 (December 8, 2008).
[60] 1:09-CV-00316 (JR) (D.D.C. February 18, 2009).
[61] "UBS agrees to pay $200 million to settle SEC charges for violating registration requirements", Litigation Release 20905, (February 18, 2009).
[62] *In the Matter of Banco Espirito Santo S.A.*, Admin Proc 14599 (October 24, 2011).

and penalties, and make whole each of its U.S. customers and clients for any realized or unrealized losses with respect to securities purchased through BES.

- Similar to BES, in *Banco Comercial Português, S.A.* [63], the SEC brought an action against BCP, also a Portuguese bank, for providing brokerage and advisory services to customers residing in the U.S. in violation of the broker-dealer and investment adviser registration provisions. For its violations, BCP was required to terminate all such business to U.S. persons unless and until BCP became properly registered. BCP was censured and required to pay a fine of $1.9 million.

- In November 2012, the SEC sued four India-based brokers for engaging in brokerage with U.S. residents using the means of interstate commerce and not registering with the SEC as a BD or using Rule 15a-6.[64] The orders against Ambit Capital Pvt. Ltd, Motilal Oswal Securities Limited and JM Financial Institutional Securities Private Limited involved brokerage. The order against Edelweiss Financial Services Limited involved private placements of Private Funds and Rule 15a-6. Among the key findings were the following:

  - "Sponsored conferences in the U.S.
  - Had employees travel regularly to the U.S. to meet with investors.
  - Traded securities of India-based issuers on behalf of U.S. investors
  - Participated in securities offerings from India-based issuers to U.S. investors."

  Solicitation played a key role in these cases.

- In July 2013, the SEC sued ABN AMRO Bank N.V.("ABN")[65] for its lack of controls relating to certain of its retail and private banking affiliates, predominantly in The Netherlands, France and Switzerland. In this case, from 2004 through 2008, ABN regularly solicited, effected transactions in securities, and provided investment advice to persons in the U.S. without being registered as a broker-dealer or investment adviser, and without qualifying for an exemption from registration. The SEC found that ABN provided such services to 5,527 accounts in the U.S. holding approximately €792 million. In most cases, these were accounts held by existing foreign brokerage clients of ABN who moved to the U.S. on a non-temporary basis, as well as by persons who maintained a primary residence in the U.S. but opened an account with an ABN foreign brokerage affiliate while abroad. ABN did not maintain sufficient procedures to prevent retail and private banking affiliates of ABN, from providing non-exempt broker-dealer and investment adviser services to U.S. persons. ABN was required to pay disgorgement and prejudgment interest of approximately $3.5 million and pay a $2 million fine.

- In February 2014, the SEC sued Credit Suisse Group AG for, *inter alia*, soliciting cross border brokerage (and investment advisory services) without being registered with the

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[63] *In the Matter of Banco Comercial Português, S.A.*, Admin Proc 3-15248 (March 18, 2013).
[64] "SEC Charges Four India-Based Brokerage Firms with Violating U.S. Registration Requirements", SEC Press Release 2012-241, November 27, 2012, https://www.sec.gov/news/press-release/2012-2012-241htm (with attendant references to Orders against Ambit Capital Pvt. Ltd.; Motilal Oswal Securities Limited; JM Financial Institutional Securities Private Limited; and Edelweiss Financial Services Limited).
[65] *In the Matter of ABN AMRO Bank, N.V., Admin Proc* 3-15401 (July 31, 2013).

SEC as a broker-dealer and an investment adviser.[66] The SEC alleged that this involved as many as 8,500 accounts, more than 100 trips to the United States to meet clients. It was also noted that while Credit Suisse did implement controls to prevent such violations (after the UBS AG enforcement action), it took several years before the activities ceased and Credit Suisse ceased to collect fees.

- In *In the Matter of HSBC Private Bank (Suisse) SA*,[67] the SEC sued HSBC for: visiting and soliciting hundreds of U.S. residents to effect transactions in securities and not registering as a BD; visiting and giving investment advice to thousands of U.S. residents and not registering as an RIA; and failing to register despite express knowledge of requirements. HSBC Bank admitted wrongdoing and consented to a censure, a cease-and-desist from further violations of U.S. law and payment of $12.5m in disgorgement.

VI. MiFID II

A significant regulatory development affecting European non-U.S. Managers and their U.S. affiliates and RIAs with European participating affiliates and counterparts, apart from the April 2018 Fiduciary Proposals[68] and the now in force EU General Data Protection Regulation, is the EU Markets in Financial Instruments Directive ("MiFID II").

MiFID II is intended offer enhanced protection for investors and increased transparency in the trading of instruments and securities. It is not disclosure-based, like the U.S. federal securities laws, but has elements of merit regulation. When a firm is subject to MiFID II and provisions of the U.S. federal securities laws, issues arise in how it complies with both sets of requirements.

The SEC Staff has issued three no-action letters to address situations where compliance with the Exchange Act or the Advisers Act would compromise compliance with MiFID II.

1. In October 2017, the Securities Industry and Financial Markets Association ("SIFMA") received a no-action letter from TM related to research payments made in reliance on the Section 28(e) safe harbor.[69] Under MiFID II, when a money manager acquires research through a soft or commission sharing arrangement it typically uses a "research payment

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[66] *In the Matter of Credit Suisse Group AG*, Admin Proc 3-15763 (February 21, 2014), http://www.sec.gov/litigation/admin/2014/34-71593.pdf.
[67] *In the Matter of HSBC Private Bank (Suisse), SA*, Admin Proc 3-16288 (November 25, 2014), http://www.sec.gov/litigation/admin/2014/34-73681.pdf.
[68] "SEC Proposes to Enhance Protections and Preserve Choice for Retail Investors in Their Relationships With Investment Professionals", Release 2018-68 (press release with links to proposals (Regulation Best Interest, RIA Interpretation and Form CRS Summary)), April 18, 2018, www.sec.gov/news/press-release/2018-68 ("Fiduciary Proposals").
[69] SIFMA, (October 26, 2017), www.sec.gov/divisions/marketreg/mr-noaction/sifma-amg-102617-28e.pdf.

account" ("RPA") that is funded with client assets. MiFID II prohibits a money manager from receiving "inducements" from a broker-dealer in exchange for execution business. Under MiFID II, when a money manager receives research in exchange for execution business, this research may be viewed as an "inducement". The SEC Staff confirmed that when the amount paid for research is identified separately from the amount paid for execution before the money manager allocates execution business, the RPA is funded with client assets and the RPA is under the control of the money manager; there will be no recommendation to the SEC for enforcement when the research is paid for using RPAs in reliance upon Section 28(e). The no-action status is conditioned upon the satisfaction of all applicable requirements under Section 28(e).

2. A BD that provides research to its clients is engaging in an activity that constitutes giving investment advice under the Advisers Act, but is not required to register thereunder if the provision of such services is solely incidental to the conduct of its business as a broker-dealer.[70] MiFID II requires the separation of research and execution payment. For a firm to be MiFID II compliant, research may be paid for directly from the firm's own account ("Inclusive Method"), from a MiFID II compliant research payment account ("Exclusive Method") or a combination of both.[71] The SEC Staff granted no-action relief for a 30 month period to SIFMA, to permit a firm that makes separate research payments in a MiFID II-compliance approach and provides research as more than an incidental part of their business from having to register under the Advisers Act.

3. A third II no-action letter issued to the ICI dealt with aggregation.[72] In a 1995 No Action Letter addressed to SMC Capital, Inc.,[73] the SEC Staff granted no-action relief to permit an RIA to aggregate orders for advisory clients. Relief was required to avoid violations of 1940 Act Section 17(d) and Rule 17d-1 thereunder, and Advisers Act Section 206 on the basis that there were procedures in place to stop one account from being disadvantaged against another. In complying with one of the two options to handle the separation of research and execution payments. As a result, the cost of a transaction may differ from client to client based on the costs associated with a research payment arrangement. This would run afoul of the no-action relief granted to SMC Capital where each client simply pays a pro rata share of all costs associated with the aggregate order. In granting no-action relief, the SEC Staff permitted a firm subject to MiFID II to aggregate orders, with the result that the participating client group pays the same average price per security and the same average execution cost but different research costs per client based on the research payment approach. A firm wishing to rely upon this no-action relief must adopt policies and procedures reasonably designed to ensure that:

   - each client in an aggregated order pays the average price for the security and the same cost of execution;

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[70] Section 202(a)(11)(C) of the Advisers Act generally excludes from the investment adviser definition any broker or dealer who performs investment advisory services and whose performance of such services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation from that activity.
[71] SIFMA (October 26, 2017), www.sec.gov/divisions/investment/noaction/sifma102617htm.
[72] ICI (October 26, 2017), www.sec.gov/divisions/investment/noaction/2017/ici102617htm.
[73] SMC Capital Inc. (September 5, 1995), www.sec.gov/investment/noaction/smccapital.pdf.

- the payment for research in connection with the aggregated order will be consistent with each applicable jurisdiction's regulatory requirements and disclosures to that client; and
- subsequent allocation of such trade will conform to the adviser's allocation statement or advisor's allocation procedures.

Apart from these three no-action letters, issues remain.

Taking elements of these letters, certain U.S. financial institutions, BDs or possibly banks, will receive research from their non-U.S. affiliates. If a BD provided research to its U.S. clients it would not, under the second no-action letter discussed above, have to register as an RIA. If a BD received research from a non-U.S. affiliate and provided that research to its U.S. clients, query whether the no-action relief would continue to apply or whether, if such a BD was required to register as an RIA, its non-U.S. affiliates would become participating affiliates.

Another issue that was not addressed in the no-action letters was custody under the Advisers Act. If an RIA subject to the Advisers Act – not a non-U.S. Manager that was an RIA but did not have direct U.S. clients (under *Unibanco*, the substantive provisions of the Advisers Act do not apply to its non-U.S. clients) used the Exclusive Method to pay for research, those funds might go into an account over which the RIA exercises authority. Under Rule 206(4)-2, an RIA that exercised authority over such funds would be deemed to have custody and must comply with the substantive provisions of Rule 206(4)-2.

VII. A Way Forward

Outside the United States, a financial services firm registers with one regulator and obtains a license to engage in one or more activities. In the United States, a firm that offers advisory and/or discretionary investment management services would register as an investment adviser under the Advisers Act and a firm that engaged in brokerage transactions for the account of others would become licensed as a broker-dealer with the SEC under the Exchange Act, the U.S. states where required and join FINRA. The U.S. registration/licensing procedures and the regulatory and compliance requirements for these types of firms differ greatly. A firm that wished to engage in both activities would require Exchange Act *and* Advisers Act registration and FINRA membership. This different approach presents regulatory hurdles and burdens for a non-U.S. Manager wishing to access the U.S. markets, or a U.S.-based firm. In a cross-border regulatory environment, harmonization in registration/licensing, compliance, supervision and examinations is the preferred approach. The U.S. regulatory policy to keep broker-dealers and RIAs separated in terms of registerable activities and oversight is in need of modernisation and reform. Cross-border activities, mutual recognition and substituted compliance are the norm in Europe and Asia and should be reflected in updated U.S. federal securities regulatory policy.

However, there remain policies, often long-standing, underlying the U.S. federal securities laws that are valid and will not change. The primary goals of the U.S. federal securities laws are to foster capital formation, protect investors, ensure fair, orderly markets, mandate full and accurate disclosure and provide for enforcement action when these are not satisfied. These should *never* change – but as markets evolve, the means by which these are effected by laws, rules and regulation does require consideration.

The issue for a non-U.S. Manager is how to access the U.S. markets in a way that helps it avoid a bifurcated approach to registration and regulation, brought on by the differing regulatory approaches to investment advisers and broker-dealers in the United States and in its home country. The issue for a U.S.-based money manager is whether it can take the occasional order to buy or sell securities for a client. Another issue is giving comfort to RIAs and ERAs that advise Private Funds to permit them to use Rule 3a4-1 as can industrial companies, noting that the protections afforded by RIAs and ERAs are similar to those of BDs. The issue for U.S. investors, institutional and individual, is how to access the non-U.S. markets and non-U.S. products in a cost-effective manner. Rule 3a4-1 was adopted in 1985 and Rule 15a-6 was adopted in 1989 – pre-internet. There have been many changes in the intervening 33 years. The focus of regulators, where investors are concerned, is how to protect them while balancing the needs of capital formation and fair, orderly and efficient markets. It is clear and no one doubts that any non-U.S. person that wishes to enter the U.S. markets must play by the U.S. rules and these rules, when violated, must be enforced.

That being said, are the laws, rules and regulations in need of a review?

Such an overhaul could include (i) modernizing Rules 15a-6 and 3a4-1, (ii) harmonizing the investment adviser and broker-dealer registration procedure and regulatory regimes in the United States and (iii) exploring other options that may be more feasible in scope.

We note the efforts to address the issue of a fiduciary duty rule currently under way in the Fiduciary Proposals.

There is an opportunity to streamline a number of defined terms that cut across the U.S. federal securities laws and certain rules thereunder to facilitate the offering of the securities of non-U.S. Private Funds to U.S. investors.

There is also an opportunity to issue a concept release on the changing role of brokerage and how interpretations under Section 3(a)(4) and how Rules 3a4-1 and 15a-6 may be modernized to reflect current market practice.

Modernize Existing Rules

Rule 15a-6, Rule 3a4-1 and the interpretative positions for Exchange Act Section 3(a)(4) were adopted and administered well for their time (the pre-internet era) but need to be updated. Their provisions do not cover all U.S. investors. Rule 15a-6 does not factor in the concept of "inadvertent brokerage" (similar to inadvertent custody). A June 2008 SEC proposal to amend Rule 15a-6[7] [4] addressed several points and, if adopted, would have expanded and streamlined the conditions under which a foreign broker-dealer could operate without triggering Exchange Act registration. Other than issuing no-action letters under Rule 15a-6 and publishing the Rule 15a-6 FAQs, and taking enforcement actions, the SEC has not taken any action with respect to this proposal and it is doubtful when, if at all, this proposal will move forward. The Rule 15a-6 FAQs provide clarity but still leave important issues unaddressed.

Three issues could be addressed in rule-making, interpretative positions or class exemptions without having to change the law:

1. “non-advisory brokerage” – a class exemption to permit occasional unsolicited client order-taking subject to conditions;
2. Where associated persons of a participating affiliate are involved with managing the same client assets as the RIA, permitting the RIA to take orders from dual hatted associated persons to buy and sell securities for co-managed funds of clients, non-U.S. and U.S. alike (fusing two streams of no-action letters);

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[7] [4] “SEC Proposes Amendments to Improve Regulation of Foreign Broker Activities in the United States (June 27, 2008), http://www.sec.gov/news/press/2008/2008-124.htm.

3. permitting RIAs and Private Fund Advisers to be able to rely upon Rule 3a4-1 to be able to sell the securities of the Private Funds they advise.

Harmonize the IA and BD Regulatory Regimes

The 2011 SEC Staff Study on Investment Advisers and Broker-Dealers (“IA/BD Study”)[75] gave insight into the U.S. legislative and regulatory regimes for these two market participants. The IA/BD Study was a Dodd-Frank Act-mandated review of, among other things, the standards by which personalized investment advice and recommendations about securities are made to retail customers and whether there were any gaps, shortcomings or overlaps in the regulatory standards to protect retail customers in providing advice about securities.

Recommendations in the IA/BD Study included "suggestions for considering harmonization of the broker-dealer an investment adviser regulatory regimes …". It was stated that these were intended to "address gaps in the regulatory regime, as well as the differences in approach that are no longer warranted, as they relate to providing personalized investment advice about securities to retail customers". As regards the licensing and registration process, it was recommended that harmonizing certain regulatory functions would be of benefit to retail investors and it was stated that Form ADV (registration form for investment advisers) and Form BD (for broker-dealers) "should be harmonized where they address similar issues" for "access to comparable information".

Dodd-Frank Section 913 mandated a study for retail investors. The IA BD Study is silent on the impact of the points considered and the recommendations that followed as they apply to institutions, pension funds and non-U.S. investors. Significantly, the study did not address the issue of the increasingly blurred roles of broker-dealers and investment advisers in several contexts, in particular, when would an investment adviser be a broker-dealer. It focused on recommendations relating to harmonizing disclosures, fiduciary duties and regulatory treatment for one segment of the market.

[75] "Study on Investment Advisers and Broker-Dealers, as Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act", January 2011, http://www.sec.gov/spotlight/dodd-frank/accomplishments.shtml#iabd (“IA BD Study”).

Apart from the Fiduciary Proposals, there is an opportunity to strive to harmonize aspects of the scope, application and regulatory regimes for BDs and RIAs.

- Harmonize the regulatory approach for "broker" and "investment adviser" and follow the approach taken by non-U.S. jurisdictions where the focus of regulation and supervision is on function and the provision of services and investments, oversight and enforcement actions for violations, not separate registrations and regulation.
- Provide for a single registration and licensing approach in terms of form and disclosure – do not use this as an opportunity to "up" the requirements for RIAs to match those for broker-dealers. Make them relevant for investors in the principle that these forms, which should be publicly available, are the "prospectuses" for clients.
- See that the "core" requirements of such firms include clear risk management (conflict of interest and risk identification and management) controls and public disclosure of material conflict of interests and the means to address them.
- Fund the SEC at a level to permit OCIE to examine *all* SEC-registered firms at least once every four years, even if by single topic thematic correspondence examinations and/or submission of materials to the SEC. Make use of thematic and/or "correspondence" examinations where documents could be requested and received by e-mail after which a series of conference calls could be used for interviews. Compliance controls are more meaningful when backed up by actual examinations.
- For RIAs, require compliance certifications by their CEOs similar to those in Sarbanes-Oxley Act Sections 302 and 906.

Other Options to Address Investment Advisers and Brokerage

There are options available to address the issue of how non-U.S. Managers may engage in limited purpose brokerage or self-directed activity for U.S. individual investors without having to register as a broker-dealer.

One option is to revise Rule 15a-6 to have the research and solicitation exemptions cover two categories of investors: 1) a QIB equivalent and 2) all others, institutional and individual. (The professional-to-professional safe harbour would remain unchanged.) At the same time, the term "major U.S. Institutional Investor" could be changed to or become the equivalent of QIB (to add parity between the Securities Act and the Exchange Act). There is a precedent in striving to achieve parity across the federal securities laws, for example, in 2011 when the SEC acted to apply the definition of U.S. person in Regulation S under the Securities Act for use under the Advisers Act, after it stated, in the release adopting now vacated Advisers Act Rule 203(b)(3)-2, that "Regulation S is designed for use in transactions, not ongoing advisory relationships, and its use in this context raises larger issues that we cannot address in this rulemaking."[7 6] Rule 15a-6 could be revised so that the term “U.S. Institutional Investors” would become “U.S. investors” and include all other investors, institutional and individual. These “U.S. investors” would be treated as U.S. Institutional Investors are today and contacts would be subject to the chaperoning requirements that apply to U.S. Institutional Investors.

Another option would be to provide a class exemption or safe harbor from broker-dealer registration, apart from Rule 15a-6, for limited purpose brokerage or self-directed activity for a home country-regulated non-U.S. Manager, subject to certain safeguards. This option would be based on substituted compliance as is the case for certain swap dealers employed by the SEC and the Commodity Trading Futures Commission, and/or mutual recognition and reporting and record-keeping and disclosure requirements.

A third option would be to permit the U.S. clients of a home country regulated non-U.S. Manager to receive certain brokerage services from such a firm, such as the ability to direct the adviser to buy or sell specific securities on the basis that this activity was ancillary to the non-U.S. Manager’s primary activities.

A fourth option would be to adopt a rule under the Advisers Act providing that self-directed brokerage is a permissible activity for investment advisers. A variation of this option would be to carve out of the definition of “broker” home country authorized and regulated non-U.S. Managers and non-U.S. firms that provide self-directed brokerage not as their primary activity and that do not receive transaction-based compensation, subject to substituted compliance, record keeping and regulatory disclosure.

[7 6] "Registration Under the Advisers Act of Certain Hedge Fund Advisers", Advisers Act Release 2333, 69 Fed.Reg. 72054, at 72071 footnote 201.

Another option would be to issue no-action relief, an interpretation or a “class exemption” to permit RIAs to receive orders from their non-U.S. participating affiliates where both firms co-manage the assets of clients, U.S. or non-U.S. resident, subject to appropriate conditions.

Yet another option would be to amend Rule 3a4-1 to permit RIAs to Private Funds to sell the securities of those funds, subject to record retention and other requirements, or issue the long-discussed request for no-action relief.

A further option would be to implement “broker-dealer lite”, in which firms would short-form register with the SEC (and become a FINRA member firm) to be a “passive” broker along the lines of TM’s “passive market-making” no-action letters to the London Stock Exchange and only take client orders to buy or sell securities or invest in Private Funds and route these to other BDs for execution – and operate “passive” internet investment portals to route orders to issuers, BDs or crowdfunding issuers for execution.

In considering these options, we note the statement in footnote 21 of the Rule 15a-6 FAQs that states: “if a foreign broker-dealer regularly effects transactions directly with or for a U.S. investor, the investor might reasonably expect to be protected by U.S. laws, regulations and supervisory structures applicable to registered broker-dealers.”[7] [7] What are these “laws, regulations and supervisory structures” (we call them “Regulatory Controls”)?

We compare in Annex A the regulatory controls currently applicable to BDs and RIAs. We note that, today, BDs are market intermediates and not fiduciaries while RIAs are not market intermediaries but are fiduciaries.

It is an opportune time for the SEC to address the issue of unequal, differing definitions across the U.S. federal securities laws and adopt amendments that smooth the avenues used to solicit U.S. investors to buy and sell the securities of non-U.S. issuers. This could begin with a concept release examining the broad definition of solicitation in the context of recent market developments, mutual recognition, the concept of a single act touching off the broker-dealer registration provisions, and the activities of non-U.S. Managers.

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[7] [7] Rule 15a-6 FAQs, fn 21.

Conclusion

As markets and investment opportunities change, so, too, should the SEC's approach to internationalization. There is an opportunity to permit non-U.S. Managers to gain access to U.S. investors, including individuals, in a manner that keeps this activity within the U.S. regulatory system, not outside it. It is better to design a regulatory solution to the present and evolving situation rather than letting investors pursue avenues to access non-U.S. markets and non-U.S. products outside the U.S. regulatory system. The options discussed above could serves as vehicles for regulatory initiatives to remove barriers that prevent non-U.S. Managers from accessing the U.S. markets and further protect the interests of U.S. individual investors as they have new, profitable markets opened to them. Market participants should provide their views to the Staff so that they may better understand the practical challenges faced by the industry and how it could be improved, and fashion a workable approach that better facilitates cross-border financial services.

Broker-dealer and RIA comparison		
	BD	RIA (not dual registered as a BD)
Fiduciary duty owed to clients	No	Yes
Registration	No (also FINRA member firm)	Yes
Licensing	Yes	No
Clarity in exemptions	Rules 3a4-1 and 15a-6, FAQs	Yes
Books and Records	Yes (complex)	Yes (in need of updating)
Examinations	YES - SEC and FINRA	SEC (OCIE)
Capital requirements	Yes - Rule 15c3-1	No
Customer asset protection	Yes - Rule 15c3-3	No
Suitability	Yes	Yes
Reasonable basis for recommendation	No	Yes
Issue contract notes for transactions	Yes - Rule 10b-10	No - but custodian issues monthly or quarterly statements
Best execution	Yes	Yes
KYC	Yes	Yes
AML	Yes	Non-U.S. Managers are subject to home country AML rules
BCP and Cybersecurity	Yes	Yes - note June 2016 proposal
Conflicts of interest	No	Yes - keep a log and disclose in Form ADV Part 2A
Risk management	Yes	Yes
Supervision and control person liability	Yes	Yes

Trading restrictions	Yes	Yes
Advertising controls	Yes	Yes
Compliance rule requirements	Yes	Yes
Preventing the misuse of inside information	Yes	Yes
Preventing the misuse of non-public client information	No	Yes
"Pay to play" rule	Yes	Yes
Custody	No	Only if RIA or related person has custody – or the RIA or related person is GP of an LP or LLP or managing member of an LLC
Public disclosure	No	Yes - Form ADV Parts 1, 2A and 2B
Privacy (consumers)	Yes	Yes
Identity theft (consumers)	Yes	Yes
Systemic reporting	Yes	Yes - Form PF
Large position reporting (more than 5% of a Section 12 registered security)	Yes	Exercising discretion and being inactive – Schedule 13G; if exercising control, Schedule 13D
Institutional reporting (more than $100m of Section 12 registered securities)	Yes	Yes – Form 13F
Own more than 10% of a Section 12 registered security	Yes	Yes
Large trader reporting (13H)	Yes	Yes
OATS reporting and other FINRA requirements	Yes	No
Contractual requirements	Yes	Yes