INVESTMENT INDUSTRY ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

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September 8, 2008

Ms. Florence E. Harmon
Acting Secretary
Securities & Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

By email to: rules-comment@sec.gov

Dear Ms. Harmon:

RE: File Number S7-16-08 – Proposed Rule for Exemption of Certain Foreign Brokers or Dealers

Thank you for providing us with the opportunity to comment on the Securities and Exchange Commission (SEC) proposal released on June 27, 2008 (the Proposal). The Proposal outlines significant amendments to Rule 15a-6, the foreign broker-dealer safe harbour from U.S. registration requirements, under the *Securities Exchange Act of 1934* (the Exchange Act).

The Investment Industry Association of Canada (the IIAC) is the professional association representing over 200 investment dealers in Canada. Our mandate is to promote efficient, fair and competitive capital markets for Canada and assist our member firms across the country.

The IIAC commends the SEC for taking this important step to liberalize cross-border securities regulation. The Proposal will enhance the ability of U.S. investors to access non-U.S. securities markets, such as the Canadian capital market.

As the IIAC has outlined in two earlier submissions to the SEC in July and September 2007, we believe that the institutional business in Canada where broker-dealers are selling Canadian securities to U.S. clients, would benefit from a more liberalized regulatory regime, particularly in terms of improved efficiencies. The IIAC is of the view that the benefits are wide-ranging and would result in benefits for not only Canadian broker-dealers and other foreign broker-dealers, but also for U.S. clients, regulators and the industry as a whole.

This IIAC submission reflects the input from our Free Trade in Securities Committee comprised of industry professionals representing a broad cross-section of investment dealer registrants across Canada. Input has been received from our large integrated firms carrying out a wide range of business in the United States, as well as from small institutional firms specializing in private placement financing and equity capital markets trading.

New "Qualified Investor" Category

We are pleased with the elimination of the previous two categories of permissible customers, with whom foreign broker-dealers may have limited contacts. Specifically, we note that the definitions of "U.S. institutional investor" and "major U.S. institutional investor" have been replaced with a single category of permissible customer: the "qualified investor".

This new category is a much needed expansion to the range of U.S. persons who may have contact with foreign broker-dealers.

The proposed reduction of the threshold asset level for institutional investors from $100 million to $25 million and the ability of foreign broker-dealers to deal with natural persons with $25 million in assets are important steps in allowing Canadian dealers access to an expanded range of U.S. investors.

We acknowledge that the term "qualified investor" has the same meaning as set forth in Section 3(a)(54) of the Exchange Act and is a standard that is well-known to the financial community. However, the IIAC notes that the proposed definition of qualified investor encompasses natural and non-natural persons that both own *and* invest not less than $25 million in investments. We understand that the ownership and investment thresholds are intended to be applied to persons as indicators of investment experience and sophistication.[1]

However, the IIAC requests clarification as to the "ownership and investment" aspect of the definition. If an entity is owned by a parent corporation, would the parent's ownership and investment activity be counted as part of the threshold? We believe there needs to be further guidance surrounding these terms.

The IIAC also notes that the definition of "qualified investor" no longer includes a registered investment adviser and removes the assets under management test that was contained in the previous definition of "major U.S. institutional investor". The previous definition included U.S. registered investment advisers with total assets under

[1] The remainder of the definition of "qualified investor" includes entities such as investment companies, banks, brokers and dealers, engaged primarily in financial activities including the business of investing, and therefore different indicators of investment experience and sophistication are applied.

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management in excess of $100 million, and SEC no-action relief expanded this definition to include any institution, including an unregistered investment adviser, that met the assets under management test. Further, we note that an "own and invest" definition would exclude hedge funds, currently a significant U.S. client base for Canadian broker-dealers.

We would suggest that both investment advisers and hedge fund managers are engaged in financial activities and have considerable investment experience and, as such, would have the requisite amount of experience and sophistication to enter into securities transactions with foreign broker-dealers under the proposed exemption. However, investment advisers and hedge fund managers do not ordinarily own the securities they manage and do not otherwise meet the criteria for a qualified investor. **Consequently, the proposed rule should be expanded to encompass an "assets under management" test of $25 million.**

While the IIAC is generally pleased with the reduction in the threshold level from $100 million to $25 million, we would suggest that the threshold could be further lowered to $10 million. The rationale behind the proposed reduction was to increase the likelihood that the investor has prior experience in foreign markets and therefore has insight into the reliability and reputation of various foreign broker-dealers. The SEC states that while this remains the correct focus, "increased access to information about foreign securities markets due to advancement in communication technology suggest that a broader spectrum of investors are likely to have this type of sophistication."[2] The IIAC would argue that this level of sophistication would not be diminished by lowering the threshold to $10 million.

In Canada, an institutional investor is defined in the Rules of the Investment Industry Regulatory Organization of Canada (IIROC). IIROC is the national self-regulatory organization which oversees all investment dealers and trading activity on debt and equity marketplaces in Canada. IIROC's mandate is to set high quality regulatory and investment industry standards, protect investors and strengthen market integrity while maintaining efficient and competitive capital markets. In Rule 2700, IIROC defines an institutional customer as, in part, "a non-individual with total securities under administration or management exceeding $10 million."

The IIAC believes that a similar definition should be applied by the SEC under Rule 15a-6.

Furthermore, the IIAC would also like to point out that the current international dealer category of registration under Canadian securities legislation would permit a U.S. broker-dealer to engage in trading with Canadian institutions which includes "a person, other than an individual or investment fund, that has net assets of at least $5 000 000 as shown

[2] Exemption of Certain Foreign Brokers or Dealers, Securities Exchange Act Release No. 58,047 (June 27, 2008), 73 Fed. Reg. 39,181 (July 8, 2008) ("Proposal").

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on its most recently prepared financial statements."[3] As a result, U.S. broker-dealers currently have a broader spectrum of Canadian institutional investors with which to do business.

Solicited Transactions – General Requirements

1. *Maintaining Books and Records*

To take advantage of Exemption (A)(1), a registered U.S. broker-dealer would be required to maintain copies of all books and records, including confirmations and statements, related to transactions effected under the Exemption. However, the books and records could be maintained at the foreign broker-dealer in a manner required by the foreign broker-dealer's local regulator. If they are maintained in such a way, the U.S. broker-dealer is required to make a reasonable determination that copies could be furnished to the SEC promptly.

The IIAC is pleased that the Proposal will allow that the books and records to be maintained at the foreign broker-dealer in the form, manner and for the period prescribed by the foreign security authority, which in our members' case, would be IIROC.

While we understand that the rationale for such a provision is to ensure that the ability of the SEC to obtain copies of the books and records is not diminished where it relates to transactions for U.S. investors, we question the requirement for a U.S. broker-dealer to be the entity making the "reasonable determination".

Removing this requirement would relieve the burden on U.S. firms and the cost for Canadian firms. **At the very least, the IIAC supports the comment by the SEC that in lieu of a reasonable determination requirement, the SEC may allow for a written undertaking by the foreign broker-dealer, filed with the SEC to furnish the books and records to the U.S. registered broker-dealer or the SEC upon request.**

A more efficient solution would be to rely upon current international agreements that allow for information sharing between jurisdictions. For example, the Intermarket Surveillance Group (ISG) is an international organization comprised of U.S. securities exchanges, U.S. securities associations (such as FINRA) and non-U.S. organizations (such as IIROC). The purpose of the ISG is to provide a framework for the sharing of

[3] See *Securities Act* (Ontario). Ontario Regulation 1015, R.R.O 1990, subsection 208(1) definition of international dealer at National Instrument 45-106 *Prospectus exempt Distributions*, definition of "accredited investor" under section 1.1. It should be noted however, that the definition of international dealer will be revised under proposed National Instrument 31-103 *Registration Requirements.*

information and the coordination of regulatory efforts among these organizations. Membership in the ISG carries with it a commitment to share information required for regulatory purposes with other members. The ISG information-sharing works both through formalized written agreement and via ad-hoc arrangements. As such**, rather than requiring a U.S. broker-dealer to carry out an intermediating role for the foreign broker-dealer under the proposed amendments to Rule 15a-6, the ISG could be used as the basis upon which the SEC could request any of the relevant information if and when it is required from a foreign broker-dealer.**

2. *Establishment of Qualification Standards*

The Proposal would require the foreign broker-dealer to determine that its associated persons involved in transactions effected pursuant to the Exemptions are not subject to statutory disqualification under Section 3(a)(39) of the Exchange Act. The Proposal would shift the burden of making this determination, which currently resides with the U.S. broker-dealer intermediating transactions under Rule 15a-6, to the foreign broker-dealer.

However, the Proposal would require the U.S. registered broker-dealer to obtain a representation from the foreign broker-dealer that it has made this determination.

The Proposal would also shift the burden of maintaining the background information with respect to each foreign associated person onto the foreign broker-dealer. This includes information such as the associated person's name, address, business employment history, disciplinary action taken, etc. The Proposal would again require the U.S. registered broker-dealer to obtain a representation from the foreign broker-dealer that it is maintaining the required information.

Lastly, the responsibility of the U.S. registered broker-dealer to maintain records of written consents to service of process for any civil action brought by or proceeding before the SEC or self-regulatory organization would shift to the foreign broker-dealer. A U.S. broker-dealer would be responsible for obtaining a representation from the foreign broker-dealer.

The Proposal states that these measures are designed to ensure that the SEC would be able to obtain the information regarding foreign associated persons if it is necessary. The SEC states in the Proposal that, "allowing U.S. registered broker-dealers to rely upon the determinations and representation of foreign broker-dealers… is a balanced approach that should address the risks to qualified investor."[4]

[4] *See* Proposal at pg. 55.

While the IIAC believes that the shifting of responsibility is appropriate as the foreign broker-dealer is in possession of the relevant information, we believe it is unnecessary to require a U.S. registered broker-dealer to be inserted into the role of obtaining the required representations and written consents.

In order to reduce barriers for foreign broker-dealers to access U.S. institutional investors and reduce the burden on U.S. registered broker-dealers, the IIAC questions the need for a U.S. firm to obtain these representations and consents. It can be burdensome for smaller Canadian broker-dealers to seek out U.S. registered broker-dealers to engage in the above role. **The IIAC recommends, as outlined above, that the ISG could be used to ensure the SEC gains access to this information when required. In the alternative, we would suggest that foreign broker-dealers provide undertakings to the SEC regarding the above responsibilities.** This achieves the same objective without diminishing investor protection concerns.

Solicited Transactions - Foreign Broker-Dealers That Conduct a "Foreign Business" – Proposed Rule 15a-6(a)(3)(iii)(A)(1)

Under the so-called Exemption (A)(1), a foreign broker-dealer may solicit a U.S. investor to buy or sell a security without SEC registration if the foreign broker-dealer conducts a "foreign business".

This Exemption would allow a foreign broker-dealer to conduct the execution, financing and clearance and settlement of trades and the custody of customer funds and securities.

A. The "Foreign Business" Limitation

Proposed Exemption (A)(1) would only be available to foreign broker-dealers when they conduct a "foreign business". The definition of a "foreign business" is where at least 85 percent of the aggregate absolute value of securities purchased or sold under the direct institutional access provisions of Rule 15a-6 is in "foreign securities", calculated on a rolling two-year basis.

We question how this test would be applied to newer, start-up foreign broker-dealers who do not have a two year prior history upon which to base the calculation. For example, if a foreign business starts on January 1 and begins to trade foreign securities to U.S. institutional investors, at the end of that year it would not have had the relevant aggregate value to make the necessary calculation. **The IIAC requests some clarification of how newer firms would make use of the exemption and how the definition of "foreign business" would be applied in these circumstances.**

Definition of "foreign securities"

The IIAC and our members believe that the definition of "foreign securities" would be potentially difficult and challenging in its application, specifically, with respect to the definition of a "foreign private issuer". Such a test would require extensive due diligence regarding the issuer's shareholders, management and business operations. Requiring a foreign broker-dealer to determine, for example, that less than 50 percent of the outstanding voting securities of an issuer are directly or indirectly owned by residents of the U.S. can prove complicated, in addition to the fact that it may require the consideration of some subjective elements.

We recommend a simplification of the foreign business test by basing the test upon the primary jurisdiction where the securities are listed on a marketplace. Basing the definition of foreign securities of a foreign private issuer upon a non-U.S. marketplace, one that is regulated in a foreign country by a foreign securities authority would provide a more simplified test.

When securities are interlisted on both a foreign and U.S. marketplace, the IIAC recommends that a jurisdiction of organization test be applied. This test would simply require a determination of the issuer's place of organization or incorporation. Both the jurisdiction of listing and jurisdiction of organization tests provide a far simpler and objective standard than the proposed foreign business test.

85 Percent Threshold

Our members support the 85 percent threshold as a fair and reasonable level in order to allow a foreign broker-dealer to continue to do a limited amount of business in U.S. securities.

60 Day Grace Period

The IIAC notes that firms have a 60 day grace period to continue to use the Exemption after falling below the 85 percent threshold. In practice, this may be difficult if a customer's funds and securities have to be moved to an affiliated U.S. broker-dealer in the event that the Exemption becomes unavailable. In addition, the cost to do so in such a short time frame would ultimately be borne by investors. **We recommend the SEC consider a longer time period and suggest that a 90 day grace period may be more appropriate.**

Visits in the United States and Communications with U.S. Investors

The IIAC is very pleased that the chaperoning requirements for communications relating to transactions under the Exemptions have been eliminated. Any oral or electronic

communications between foreign advisers and qualified investors will no longer require the participation of an associated person of a registered U.S. broker-dealer. The elimination of this requirement removes one of the most cumbersome aspects of Rule 15a-6, one that resulted in very few Canadian firms relying upon it in the past.

The same exemption would apply to in-person visits of foreign associates and U.S. investors. Again, the IIAC is pleased that the SEC will permit greater flexibility and increased ability for foreign broker-dealers to visit and conduct in-person business with their clients located in the U.S.

We are also encouraged by the proposed expansion of the number of days an associated person of a foreign broker-dealer can visit qualified U.S. investors, from the current 30 days to 180 days.

However, **we seek clarification whether the 180 day period is for a foreign broker-dealer on a firm-wide basis or if it will be applied with respect to each individual foreign associated person.**

Further, we would suggest that the SEC consider that if the visits over a calendar year amount to more than 180 days in the aggregate, the foreign broker-dealer would be permitted to continue to visit qualified clients in the United States provided a U.S. registered broker-dealer is present for such visits (i.e. continuing the chaperoning requirements in those circumstances).

Provision of Research Reports

Paragraph (a)(2) of Rule 15a-6 concerns the conditions under which foreign broker-dealers are permitted to distribute research reports to certain U.S. investors without triggering the broker-dealer registration requirements.

Currently, the only change proposed by the SEC is to replace the reference from major U.S. institutional investors to qualified investors.

However, elsewhere in the Proposal, the SEC has explained that with respect to solicited trades in general, it has allowed foreign broker-dealers to have a "greater role in effecting" transactions. Further, the SEC has stated that it is allowing "qualified investors the more direct contact they seek with those expert in foreign markets and foreign securities, without certain barriers such as the chaperoning requirements that may be unnecessary in light of other protections and investor sophistication."[5]

Consequently, if foreign broker-dealers are permitted greater scope in soliciting U.S. investors, **we would suggest that the current condition that a foreign broker-dealer not initiate contact with qualified investors to follow up on the research report be removed.**

[5] *See* i*d.* at p. 28.

Further, we recommend that the SEC continue the application of the interpretation statement which allows a U.S. broker-dealer to distribute non-U.S. research to any U.S. person through a U.S. registered broker-dealer that accepts responsibility for the contents of the research.

Implication for State-by-State Requirements

The IIAC seeks clarification of the implication that the Proposal would have with respect to State laws. What is the potential application of individual State registration requirements? Will the federal proposal have the ability to pre-empt State requirements? Will this potential pre-emption be applicable to all States?

Exemption from OATS Requirements

Under proposed Exemption (A)(1), a foreign broker-dealer would be permitted to effect all aspects of securities transactions with qualified investors, including receiving and executing the orders. The U.S. broker-dealer would no longer be required to maintain accounts for customers, issue confirmations and account statements and receive, deliver or safeguard funds and securities. **As a result, the IIAC would like to confirm its understanding that foreign broker-dealers would be exempt from the FINRA's Order Audit Trail System (OATS) requirements**. As the trades will be executed by the foreign-broker-dealer, who is not a FINRA member, these firms should be exempt from filing OATS reports.

U.S. Licensed Approved Persons Currently Located in Canada

A number of IIAC members currently run a U.S. registered subsidiary of their Canadian registered broker-dealer. As a result, numerous Canadian approved persons are registered in the U.S. and satisfy the proficiency, licensing and ongoing continuing education requirements in the U.S. as prescribed by the Financial Industry Regulatory Authority.

In order to continue dealing with U.S. retail clients or U.S. institutional clients that do not satisfy the definition of qualified investor under the Proposal (or in other isolated circumstances), these approved persons will continue to be registered in the U.S.

The IIAC requests clarification that there would be no impediment to continuing to employ U.S. licensed persons who may work along side individuals who are dealing with U.S. qualified investors under the proposed Rule 15a-6.

Effect of the Proposed Rule

Many of our members have indicated that as a result of the Proposal Canadian firms would be able to consolidate their operations in their Canadian registered firm. This would relieve Canadian firms of the bifurcation of capital between their Canadian and

U.S. registrants, the need to comply with two sets of registration requirements, dual books and records, two sets of trading tickets, dual written supervisory procedures, two compliance regimes in areas such as opening clients accounts and client documentation requirements, compliance training, and dual net capital requirements and monitoring. These inefficiencies and excessive costs as a result of this duplication will be removed once there is no longer a need to maintain and adhere to duplicate regulatory environments.

Clients in the U.S. will also benefit from the reduction of these costs and inefficiencies. As more Canadian broker-dealers enter the U.S. institutional market, institutional clients will be presented with greater investment choice. Further, U.S. institutional clients will gain greater insights into the Canadian markets and Canadian investment opportunities by drawing on the full range of professional resources within the firm, instead of restricting access only to dually-registered traders.

For many of the larger Canadian firms that have a large U.S. based subsidiary, such as the bank-owned firms, they will continue their operations in the U.S. as these firms not only deal with U.S. securities but also U.S. retail clients. However, they have indicated that many of their Asian and European operations that conduct transactions with U.S. institutional investors would greatly benefit from the relaxed requirements of proposed amendments to Rule 15a-6.

In closing, the IIAC would like to reiterate its support of the SEC's broader work in the area of mutual recognition arrangements with foreign jurisdictions, such as Canada. We share the SEC's view that regulatory recognition of foreign jurisdictions can reduce costs in obtaining foreign securities in the U.S., without jeopardizing protection for U.S. investors. We believe that immediate efforts to reform Rule 15a-6 can operate in conjunction with the longer-term efforts to implement mutual recognition.

The IIAC and our members look forward to the next steps in the development of revisions to Rule 15a-6 and we would be more than pleased to respond to any questions that you may have regarding this submission.

Yours sincerely,

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