Cross-Border M&A Activity May Run Afoul Of U.S. Broker-Dealer Registration Requirements

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Even in the current environment, globalized financial markets are increasingly presenting financial institutions and companies with opportunities to invest and grow their businesses internationally through cross-border transactions. A number of well-known factors continue to drive this trend, including technology, competition, flows of investment and evolving regulatory regimes that permit greater access to markets outside a company's home country jurisdiction. However, these new opportunities can be accompanied with new—and sometimes hidden—regulatory concerns for the financial institutions advising the parties involved in cross-border transactions.

Financial institutions located and operating from outside the United States (generally referred to herein as "foreign" firms) should be aware that their activity in connection with cross-border merger and acquisition transactions involving a U.S. party may inadvertently trigger U.S. federal broker-dealer registration requirements, even where the foreign firm is representing a non-U.S. party to the transaction. Failure to register when required to do so may lead to scrutiny and potential enforcement action by the U.S. Securities and Exchange Commission, not only with respect to the foreign firm but also with respect to any U.S.-based entities (regardless of their U.S. registration status) involved in the transaction. This publication is intended to summarize potential options for foreign financial institutions involved in cross-border M&A transactions to avoid U.S. broker-dealer registration and mitigate potential enforcement risks.

Summary of U.S. Broker-Dealer Registration Requirements

Under U.S. federal securities laws, and subject to certain exceptions, an entity generally must register with the SEC as a broker and/or dealer if it uses any form of U.S. interstate commerce to

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engage in a business of effecting transactions in securities for the account of others (broker activity) or in a regular business of buying and selling securities for its own account (dealer activity).[1] The SEC broadly interprets what it means to act as a securities broker or dealer. For example, the SEC has taken the position that any person who receives "transaction-based compensation" in connection with the securities transactions of others (including any compensation tied to the size and/or consummation of one or more securities transactions) may be deemed to be acting as a broker. Because many firms' business includes both broker and dealer activity, firms are often referred to collectively as broker-dealers. In the context of M&A transactions involving securities, the financial institutions representing and advising the parties to the transactions are often at risk of being characterized as brokers. U.S. interstate commerce also is defined broadly, and the SEC generally takes the position that the broker-dealer registration requirements apply regardless of a firm's physical location—*i.e.,* that any firm using U.S. interstate commerce to act as a securities broker or dealer is within its jurisdictional reach.[2]

While foreign firms are eligible to register with the SEC as broker-dealers, registration should not be taken lightly. At the federal level, SEC-registered broker-dealers are heavily regulated by the SEC and are also required to become members of at least one self-regulatory organization (most typically, FINRA). Beyond the obvious compliance burdens, there may also be tensions between the U.S. broker-dealer regulatory regime and that of the foreign broker-dealer's home country jurisdiction. At the same time, a firm's failure to register, if required to do so, can lead to SEC enforcement action.[3]

For all of these reasons, foreign broker-dealers involved in cross-border securities-related activities, including M&A transactions, must tread cautiously if they wish to avoid coming under the SEC's jurisdiction.

Potential Options Available to Foreign Broker-Dealers Involved in Cross-Border M&A Activities

Foreign broker-dealers may be involved in cross-border securities transactions if they comply with certain requirements and stay within certain lanes of permitted activity. The following provides a summary of such permitted activities that should not trigger U.S. broker-dealer registration. All subsequent references to a foreign firm or foreign broker-dealer are intended to refer to an entity that has no presence or operations within the physical jurisdiction of the United States.

As discussed below, SEC Rule 15a-6, along with no-action relief issued by the SEC staff, provides foreign broker-dealers with a

number of potential avenues under which they may be involved in cross-border M&A-related securities transactions without triggering the SEC's broker-dealer registration requirements. The determination as to which options may be legally viable—not to mention practicable—will depend on the nature of the transaction at issue, as well as the foreign broker-dealer's business and its desired role in connection with the transaction.

Rule 15a-6 under the Exchange Act

Rule 15a-6 provides foreign broker-dealers with certain exemptions from the U.S. federal broker-dealer registration requirements, so long as they limit their broker-dealer activities involving U.S. interstate commerce and U.S. persons to those permitted under the rule. The rule contains a number of nuances but, generally, the rule exempts four categories of activity by foreign broker-dealers:

(1) effecting transactions in securities with or for persons that were not solicited by the foreign broker-dealer (it should be emphasized that the relationship itself must be deemed unsolicited, not merely the individual transaction(s); moreover, the SEC has a very broad interpretation of "solicitation" for these purposes);
(2) furnishing research reports to "major U.S. institutional investors" and effecting transactions in the securities discussed in those reports with or for those "major U.S. institutional investors" (provided certain additional conditions are satisfied);
(3) inducing or attempting to induce the purchase or sale of a security by a "U.S. institutional investor" or "major U.S. institutional investor," provided that (i) any resulting securities transactions are effected through a U.S. registered broker-dealer, (ii) the U.S. broker-dealer follows detailed "chaperoning" requirements in connection with the activities of the foreign broker-dealer and its personnel, and (iii) various other specific conditions are satisfied (often referred to as the "chaperoning exemption"); and
(4) effecting transactions in securities with or for, or inducing or attempting to induce the purchase or sale of a security by, certainly narrowly defined categories of persons, including a U.S. registered broker-dealer acting as principal for its own account or as agent for others (in the context of a foreign broker-dealer interacting with a U.S. registered broker-dealer, this exemption is often referred to as the "dealer to dealer" or "back to back" exemption).

Each of the Rule 15a-6 exemption categories is the subject of additional SEC interpretive guidance, and determining whether

a foreign firm may appropriately tailor its activity in order to avail itself of one or more of the exemptions involves careful planning and execution. Even firms that attempt to structure their conduct in a way that comports with all of the rule's requirements may misstep.

In the context of cross-border M&A transactions, foreign firms typically only explore reliance upon the latter two Rule 15a-6 exemptions, each of which presents its own business and regulatory limitations. The reality is that Rule 15a-6 is written more in contemplation of secondary market relationships and transactions, and reliance upon the rule may not be practical in certain cross-border M&A scenarios.

● *Reliance upon the "chaperoning exemption" for cross-border M&A transactions*

There are several practical challenges to relying upon the chaperoning exemption in the context of cross-border M&A transactions. Among other things, Rule 15a-6 narrowly defines the term "U.S. institutional investor" in a manner that does not include most public or private companies. Although the term "major U.S. institutional investor" is also narrowly defined in the rule, the SEC staff has, through interpretive guidance, effectively expanded the definition of a "major U.S. institutional investor" to include additional categories of institutions that have aggregate "financial assets," or in some cases "total assets," in excess of U.S. $100 million. Nonetheless, the U.S. party to a prospective M&A transaction might not satisfy the requisite asset level requirements. Moreover, even when the U.S. party does satisfy the requirements, a foreign broker-dealer seeking to rely upon the chaperoning exemption may find it difficult to arrange for a U.S. broker-dealer to perform the chaperoning functions, unless it has an affiliated U.S. registered broker-dealer willing to serve this role. (Due to the nature of the responsibilities imposed upon the chaperoning broker-dealer, many U.S. registered broker-dealers have a general policy of only providing chaperoning services to their affiliated entities, although there is no legal requirement that the two firms be affiliated). In addition, foreign broker-dealers should assess the chaperoning requirements and necessary coordination with a U.S. registered broker-dealer from both a business and economic perspective.

● *Reliance upon the so-called "back to back" exemption for cross-border M&A transactions*

The "back to back" exemption permits a foreign broker-dealer to solicit and effect securities transactions with a U.S. registered broker-dealer, even in circumstances where the U.S. registered

broker-dealer is acting on behalf of other categories of U.S. persons with whom the foreign broker-dealer would not be permitted to interact directly. In the context of a prospective cross-border M&A transaction where a U.S. registered broker-dealer is advising the U.S. party and the foreign broker-dealer is advising the non-U.S. party, this exemption would permit the foreign broker-dealer to negotiate with the U.S. registered broker-dealer. However, this exemption would not permit the foreign broker-dealer to directly solicit or otherwise participate in negotiations with the U.S. broker-dealer's client (*i.e.,* the U.S. party), notwithstanding that the foreign broker-dealer is representing the other side (*i.e.,* the non-U.S. party) in the transaction. Another situation in which a foreign broker-dealer may wish to rely upon this exemption is where it is representing a non-U.S. client and would like to retain the services of a U.S. registered broker-dealer to identify and directly negotiate with prospective U.S. parties.

M&A Related No-Action Relief

For foreign broker-dealers involved in cross-border M&A transactions, certain SEC staff no-action letters afford some additional flexibility, but each comes with its own set of limitations and drawbacks.

- *Foreign broker-dealer acting on behalf of a non-U.S. client*

One SEC no-action letter addresses the circumstance of a foreign broker-dealer that is retained by a non-U.S. client in connection with a prospective M&A transaction.[4] Under this no-action letter, the SEC staff permits the foreign broker-dealer to directly approach a U.S.-based target buyer or seller, provided the U.S. target qualifies as a "major U.S. institutional investor," to explore the target's interest in a transaction with the firm's non-U.S. client. If the U.S. target expresses interest, the no-action letter also permits the foreign broker-dealer to interact and negotiate with the U.S. target where either:

- the U.S. target is using personnel with relevant M&A experience to negotiate the transaction, so long as (i) the persons acting on behalf of the U.S. target are not associated with a U.S. registered broker-dealer, and (ii) any foreign broker-dealer personnel who have contact with the U.S. target in the United States satisfy certain requirements of Rule 15a-6; or
- the U.S. target is using the services of an external advisor (such as a broker-dealer) with relevant experience.

This no-action relief is valuable because it allows a foreign broker-dealer representing a non-U.S. client in connection with a

cross-border M&A transaction to engage in relatively unfettered interactions and negotiations with the U.S. target, without the need to retain the services of a U.S. "chaperoning" broker-dealer, so long as the U.S. target is appropriately represented by its own knowledgeable internal or external advisors. When it is available, this option affords a foreign broker-dealer with substantially more flexibility than the "back to back" exemption noted above. Nonetheless, this option is only available when: (i) the client is a non-U.S. person/entity; and (ii) the U.S. target qualifies as a "major U.S. institutional investor."

● *Brokering certain narrow categories of M&A transactions*

Under another no-action letter, the SEC staff permits an unregistered "M&A Broker"—regardless of where it is based or has operations—to effect securities transactions in connection with the transfer of ownership of a privately-held company, provided certain conditions are satisfied.[5] The relief letter also does not impose any conditions on the physical location of the parties to the transaction. As with Rule 15a-6 and other no-action relief, however, the staff's no-action letter is peppered with caveats. To begin with, the "M&A Broker" must be engaged in the business of effecting securities transactions solely in connection with the transfer of ownership and control of a privately-held company through the purchase and sale of securities or assets of a company to a buyer that will actively operate the company (or the business conducted with the assets acquired from the company). Thus, the relief would not be available in connection with M&A transactions involving the sale of a public company and/or sales to any "passive" buyers.

The relief is also subject to a laundry list of additional conditions, including: (i) the M&A Broker must not have the ability to bind either party to the M&A transaction; (ii) neither the M&A Broker nor its affiliates may provide financing for the transaction, and if the M&A Broker assists in finding financing from unaffiliated third-parties, it must disclose to its client, in writing, any compensation in connection with that role; (iii) the M&A Broker may not control securities or funds related to the transaction; (iv) the M&A Broker and its personnel must not have been barred from association with a broker-dealer by the SEC, any state or any self-regulatory organization and must not be suspended from association with a broker-dealer; and (v) the M&A transaction must not involve a public offering (rather, any offer or sale of securities must be conducted in reliance upon an available exemption from registration under the Securities Act of 1933).

Once again, this option is valuable when it is available. At the same time, M&A transaction structures and negotiations can be

fluid, rendering it difficult for a foreign broker-dealer to ensure that the ultimate transaction will satisfy the necessary criteria.

Serving as a "Foreign Finder" for a U.S. Registered Broker-Dealer

If other options are either unavailable or unattractive, yet another potential avenue for a foreign broker-dealer is to act as a "foreign finder" for a U.S. registered broker-dealer, in accordance with FINRA Rule 2040(c). This would be a very limited role. As a "foreign finder," the foreign broker-dealer would not be substantively involved in the cross-border transaction and negotiations; however, the foreign broker-dealer would be permitted to receive "transaction-based compensation" from a U.S. registered broker-dealer to whom it referred a non-U.S. client for prospective M&A services. For example, this may be a viable option in a situation where the foreign broker-dealer is unable to handle the engagement and perform the services directly.

Foreign firms therefore have a variety of paths to avoid being required to register with the SEC in connection with an M&A transaction. Choosing the best route—and staying on it—can involve delicate assessments and a sensitive understanding to how the SEC staff has viewed activity surrounding other M&A transactions. As a result, foreign firms involved in M&A transactions that may involve U.S. investors, firms, or markets should assess the best way to approach U.S. registration requirements before engaging in activity that may trigger those requirements.

Collaboration between U.S. Registered Broker-Dealers and Foreign Broker-Dealers

Some, but not all, of the potential avenues for foreign broker-dealers noted above contemplate various degrees of collaboration with a U.S. registered broker-dealer. For example, there may be situations where a U.S. registered broker-dealer has relationships or expertise that may prove valuable in identifying and negotiating with prospective U.S. targets. Similarly, there may be situations in which a U.S. registered broker-dealer would like to draw upon the relationships and expertise of a foreign broker-dealer, such as when a U.S. registered broker-dealer is representing a client that would like to pursue a transaction with a non-U.S. target.

These types of collaborations often have obvious practical benefits. However, regulators may question whether the firms have become so entwined in their engagement so as to effectively be operating as a single firm, and therefore suddenly subject to a host of unexpected regulations and requirements. As a result, when a U.S. registered broker-dealer and a foreign broker-dealer

are collaborating to serve the needs of a common client, care must be taken to preserve appropriate distinctions between the two firms and their respective personnel, not only to avoid confusion on the part of the common client but also to avoid a course of conduct under which one firm's personnel are effectively functioning as associated persons of the other firm. Care must also be taken to ensure that each firm complies with its regulatory obligations and any related limitations (including those applicable to the foreign broker-dealer under the various potential options previously discussed). If either firm oversteps the bounds of their respective obligations or limitations, both firms may find themselves subject to regulatory scrutiny and potential enforcement action.[6]

U.S. Firms May Face Regulatory Risks by a Foreign Firm's Failure to Register

In the context of cross-border M&A transactions, the failure of a foreign broker-dealer to register may also expose U.S.-based broker-dealers to liability.[7] This remains true even if the U.S.-based firm is appropriately registered with the SEC and FINRA. For FINRA members, their involvement may result in primary violations of a host of FINRA rules, including rules relating to supervision and the use of foreign finders. The Exchange Act also gives the SEC broad authority to bring an enforcement action against U.S. broker-dealers and others for aiding-and-abetting or causing a foreign firm's primary violation of the U.S. federal securities laws. Whether a U.S. firm may be subject to liability for a foreign firm's noncompliance with the U.S. federal broker-dealer registration requirements is heavily fact dependent and may depend on intricate factual questions regarding the conduct of both firms. U.S. firms should be mindful that the SEC may bring an action for aiding-and-abetting or causing a foreign firm's violation even if it elects to not bring an enforcement action against the foreign firm.

As such, prior to engaging in business activities with a foreign firm, U.S. broker-dealers engaged in cross-border M&A activity should carefully assess their interactions with foreign firms, including (among other things) undertaking due diligence on the foreign firm's activities and registration status (or lack of registration) to better understand potential regulatory risks.

Conclusion

U.S. and foreign firms are increasingly being presented with opportunities to engage in cross-border M&A activity. These new opportunities, however, are accompanied by the continued risk that a firm may run afoul of applicable U.S. regulations. To avoid

inadvertently crossing the regulatory lines drawn by the SEC and FINRA, firms should take steps to carefully plan all phases of their cross-border M&A activity.

NOTES:

[1]This publication is limited to a discussion of the potential U.S. federal broker-dealer registration implications associated with cross-border M&A activity and does not discuss other issues that should also be considered, including the potential application of the broker-dealer registration provisions of the individual states or the U.S. federal or state registration requirements for investment advisers.

[2]The Securities Exchange Act of 1934 generally does not authorize the Commission to require registration of a broker-dealer whose business is conducted purely extraterritorially. *See Morrison v. Nat'l Australia Bank, Ltd.,* 561 U.S. 247 (2010); *see also SEC v. Benger,* 934 F. Supp. 2d 1008 (N.D. Ill. 2013) (relying on Morrison when interpreting the reach of Section 15(a) of the Exchange Act). Whether a transaction is sufficiently domestic to require registration pursuant to Section 15(a) can require balancing a variety of factors, and the Commission often adopts a maximalist view of its jurisdiction. Consistent with that approach, the Commission has not revised the relevant guidance following *Morrison* and *Benger*. As a result, at times courts and the Commission may disagree about whether registration is required.

[3]See, e.g., In the Matter of Bank Leumi le-Israel B.M., Leumi Private Bank, and Bank Leumi (Luxembourg) S.A., Exchange Act Release No. 79113 (Oct. 18, 2016) (European firm fined $1.5 million for "providing cross-border brokerage services" and "providing cross-border investment advisory services to clients in the U.S." without registering with the SEC); In the Matter of Ambit Capital Pvt. Ltd., Exchange Act Release No. 68295 (Nov. 27, 2012) (action against India-based firm for "systematically solicit[ing] U.S. institutional investors for the purpose of providing brokerage services" without registering with the SEC or meeting the conditions for exemption from registration, but not imposing a fine due to the firm's cooperation with the SEC's investigation); In the Matter of Banco Espirito Santo S.A., Exchange Act Release No. 65608 (Oct. 24, 2011) (European firm fined $4.95 million for "providing brokerage and advisory services to U.S. Customers and U.S. Clients" without registering with the SEC and selling unregistered securities).

[4]Roland Berger Strategy Consultants, SEC No-Action Letter (May 28, 2013).

[5]M&A Brokers, SEC No-Action Letter (Jan. 31, 2014).

[6]See, e.g., *Lek Securities Corp*, FINRA Order Accepting Offer of Settlement, Disp. Proc. No. 20110297130-04 (Dec. 17, 2019) (alleging U.S. registered broker-dealer aided and abetted a third party's unregistered broker-dealer activity where the third party did not meet the requirements of being a foreign finder); In the Matter of Merrimac Corp. Secs., Inc. et al., Securities Exchange Act Release No. 86404 (July 17, 2019) (concluding that a U.S. registered firm that used foreign finders had violated a number of FINRA rules, including the requirement to have reasonable procedures concerning the use of foreign finders); *South Street Securities, LLC*, FINRA Letter of Acceptance, Waiver and Consent, No. 2016047737402 (May 2017) (alleging U.S. registered broker-dealer violated FINRA Rules 2040 and 2010 by paying fees that were based on securities transactions to entities that were not registered as broker-dealers and did not qualify for an exemption from registration); *Monex Securities, Inc.*, FINRA

Letter of Acceptance, Waiver and Consent, No. 2008014078801 (Apr. 2011) (alleging failure to properly register and supervise foreign finders).

[7]While this publication focuses on federal broker-dealer registration issues and related guidance, the states also require registration and can be equally aggressive in pursuing enforcement actions for actors who fail to comply with state law requirements.