SEPTEMBER 5, 2017

Milne Legal Press Release

Should Your Non-U.S. Firm be Registered as a Broker-Dealer with the SEC?

I. Introduction

Should your non-U.S. firm be registered with the U.S. Securities and Exchange Commission ("SEC") as a "broker" or as a "dealer" (both terms referred to herein collectively as "broker-dealers")?[1]

Milne Legal ("ML") often receives this inquiry from firms organized outside the United States (herein referred to as "Non-U.S. Firms") that either: (i) **are** registered with the SEC as an investment adviser under the Investment Advisers Act of 1940 (the "Advisers Act"), or (ii) **are not** registered with the SEC in any capacity, i.e., not as an investment adviser under the Advisers Act and not as a broker-dealer under the U.S. Securities Exchange Act of 1934 (the "Exchange Act"), but which conduct brokerage activities exclusively outside the United States ("U.S.) for non-U.S. clients.

Whether your Non-U.S. Firm will be required to register as a broker-dealer with the SEC requires a close examination of the specific facts and circumstances surrounding your firm's business activities. Particularly, one must evaluate whether the Non-U.S. Firm: (i) meets the definition of a broker-dealer as described under the Exchange Act; [2] (ii) provides brokerage services to U.S. Persons; [3] or (iii) uses U.S. jurisdictional means in carrying out its brokerage activities.[4] ML will touch on each of these three subjects below.

---

[1] The term "broker" is defined under Section 3(a)(4) of the Exchange Act and the term "dealer" is defined separately under Section 3(a)(5). Often, the term "broker-dealer" is used collectively to refer to both definitions and their registration obligations under the Exchange Act. The specific differences between the two terms is beyond the scope of this article. The focus herein will be on the definition of broker and not dealer activities.

[2] See supra. note 1 herein.

[3] The term "U.S. person" used throughout this Press Release has the same meaning as defined under SEC Regulations S Rule 902(k) ("Regulation S") which applies a territorial approach, which means that for individuals, it is based on a person's "residency" in the United States and not on a person's citizenship.

[4] Under Section 15(a)(1) of the Exchange Act, broker-dealer registration is required for any broker or dealer using U.S. jurisdictional means (referred to as "interstate commerce") "to effect

This Press Release has been prepared by ML for general informational purposes only. It does not constitute legal advice, and is presented without any representation or warranty as to its accuracy, completeness or timeliness. Transmission or receipt of this information does not create an attorney-client relationship with ML. The contents of this presentation may constitute attorney advertising under the regulations of various jurisdictions including the State of New York.

Milne Legal GmbH · Europaallee 41 · 8021 Zurich – Switzerland · +41 44 214 6752 · www.milnelegal.com

II. Who is a Broker-Dealer under the Exchange Act?

Section 3(a)(4) of the Exchange Act defines a broker in the following way:

> *"any person engaged in the business of effecting transactions in securities for the account of others."*

The two phrases "***engaged in the business***" and "***effecting transactions"*** are not specifically defined in the Exchange Act but can be better understood by referring to no-action guidance provided by the SEC staff. In addition to these two important phrases, the person must be acting for the "account of others" and "securities"[5] must be involved in the transaction for the person to meet the definition of a broker.

A. Engaged in the Business.

The SEC has stated that a person may be determined to be "engaged in the business" of providing brokerage activities if, among others: (i) the person receives transaction-related compensation (often referred to as the "hallmark" of brokerage activity); [6] (ii) the person holds himself out to the U.S. public as a broker (e.g., by use of mail, email, telephone, publication or marketing materials); and (iii) the person participates in the security transaction business on a repetitive or continuous basis.[7]

---

transactions in, or to induce or attempt to induce the purchase or sale of, any security" unless an exemption is otherwise available.

[5] See the long list of instruments defined as a "Security" under Section 3(a)(10) of the Exchange Act which includes the following: *"any note, stock, treasury stock, security future, security-based swap, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting- trust certificate, certificate of deposit for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities ex-change relating to foreign currency, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited."*

[6] See John R. Wirthlin, SEC No-Action Letter (January 19, 1999); See also Exchange. Act Rel. No. 20,943 (1984).

[7] Bondglobe, Inc., SEC Staff No-Action Letter (February 6, 2001). See also the following statement made by the SEC staff: A securities distribution effected by persons associated with an issuer, viewed in isolation, would not generally raise questions as to whether the persons effecting the distribution were engaged in the business of effecting transactions in securities. On the other hand, the ***repetitive or continuous involvement*** of persons in effecting transactions for a series of issuers, or even a single issuer, may indeed suggest that the person engaged in that distribution

This Press Release has been prepared by ML for general informational purposes only. It does not constitute legal advice, and is presented without any representation or warranty as to its accuracy, completeness or timeliness. Transmission or receipt of this information does not create an attorney-client relationship with ML. The contents of this presentation may constitute attorney advertising under the regulations of various jurisdictions including the State of New York.

B. Effecting Transactions.

Although not an exhaustive list, a person may be determined to be "effecting transactions in securities" if the person performs any of the following activities: (i) solicits investors to enter into security transactions; (ii) executes or negotiates the execution of securities transaction or otherwise brings buyers and sellers of securities together; (iii) participates in structuring security transactions or helps issuers to identify potential purchasers of securities; or (iv) distributes documents to prospective investors providing details on securities.[8]

If the Non-U.S. Firm's business activities falls within the broad definition of a broker-dealer under the Exchange Act, then the firm must consider whether it uses any aspect of "***U.S. Jurisdictional Means***" when carrying out its brokerage business.

III. U.S. Jurisdictional Means

Unless an exclusion or exemption[9] is available, Section 15(a)(1) of the Exchange Act makes it unlawful for any broker-dealer to make use of the mails or any means or instrumentality of interstate commerce (commonly referred to as "U.S. Jurisdictional Means") to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security unless the broker-dealer is registered with the SEC.

Therefore, not only must a Non-U.S. Firm meet the definition of a broker-dealer under the Exchange Act, but such Non-U.S. Firm's broker-dealer activities must "make use of" some aspect of U.S. Jurisdictional Means in order to trigger broker-dealer registration with the SEC. Therefore, one may conclude that brokerage firms organized outside the U.S. which exclusively operate outside the United States for non-U.S. clients[10] will not be required to register as a broker-dealer under the Exchange Act.

process are doing so as part of a ***regular business*** and are therefore brokers. 42 Fed. Reg. 5084, 5085 (Jan. 27, 1977)(emphasis added).

[8] See Davenport Management Inc., SEC No-Action Letter (1993), and Victoria Bancroft, SEC no-Action Letter (1987).

[9] For example, Rule 15a-6 under the Exchange Act provides a limited exemption to foreign broker-dealers that provide unsolicited security transactions to U.S. Persons inside the U.S. This is a limited exemption given how broadly the SEC defines the word solicitation.

[10] See Supra note 3 herein.

This Press Release has been prepared by ML for general informational purposes only. It does not constitute legal advice, and is presented without any representation or warranty as to its accuracy, completeness or timeliness. Transmission or receipt of this information does not create an attorney-client relationship with ML. The contents of this presentation may constitute attorney advertising under the regulations of various jurisdictions including the State of New York.

IV. Registered Investment Advisers and Broker-Dealer Registration

The same analysis above applies for determining whether a Non-U.S. Firm, which is registered with the SEC as an investment adviser under the Advisers Act, must also register as a broker-dealer with the SEC as required under the Exchange Act. Said differently, there is no exemption or exclusion from broker-dealer registration based solely on a firm being registered with the SEC as an investment adviser. Instead, an investment advisory firm must closely evaluate whether its activities trigger broker-dealer registration under the Exchange Act similar to any other firm not registered with the SEC.

A. Registered Investment Advisers Routing Security Orders to Brokers

The SEC staff has issued a line of no-action letters[11] over the years all of which conclude that the staff would not recommend enforcement action for failing to register as a broker-dealer if the registered investment adviser satisfied the following three conditions: (i) the adviser does not receive transaction-related compensation (i.e., the so-called "hallmark" of a brokerage business) for routing the security orders; (ii) the adviser does not have possession of clients' funds or securities (i.e., is not the custodian of the clients' assets); and (iii) the adviser routes the clients' orders to an SEC registered broker or to a U.S. bank for execution.[12]

In an SEC No-Action letter to InTouch Global, LLC, the SEC staff stated the following:

> *"The staff has considered the issue of whether registered investment advisers must also register as broker-dealers in a number of specific circumstances. For example, in Letter re: First Atlantic Advisory Corp (February 20, 1974), the staff took a no-action position with respect to broker-dealer registration of a registered investment adviser that proposed to transmit orders for securities to registered broker-dealers, banks, or trustees for execution when the investment adviser did not hold client funds or securities and did not receive any compensation specifically for*

---

[11] See e.g., InTouch Global, LLC, (pub. avail. Nov., 14, 1995); Invest-Centro U.S.A., Inc., SEC No-Action Letter (Oct. 30, 1989); and First Atlantic Advisory Corp., (pub. avail. Mar. 22, 1974).

[12] See Robert E. Plaze, "*Regulation of Investment Advisers by the U.S. Securities and Exchange Commission*", June 2017, page 105, where it states the following: "*Some traditional advisory activities undertaken on behalf of clients such as transmitting orders to broker-dealers may be encompassed by the Exchange Act definitions. The SEC staff has not, however, required investment advisers to register as a broker-dealer if the adviser: (i) does not receive transaction-related compensation; (ii) does not have possession of its client's securities; and (iii) does no more than route the orders to an SEC-registered broker or a bank or trust company for execution.*" (Emphasis Added).

This Press Release has been prepared by ML for general informational purposes only. It does not constitute legal advice, and is presented without any representation or warranty as to its accuracy, completeness or timeliness. Transmission or receipt of this information does not create an attorney-client relationship with ML. The contents of this presentation may constitute attorney advertising under the regulations of various jurisdictions including the State of New York.

> *this activity from any person" (emphasis added).*[13]

In another no-action letter, First Atlantic Advisory Corp., a registered investment adviser, inquired with the SEC whether it would be obligated to register as a broker if it merely routed clients orders to a broker for execution:

> *"[First Atlantic Advisory Corp.] would simply, through a proper power of attorney or other instrument, give the order for the transaction to be effected by some other third person such as a trustee, bank or securities broker. [First Atlantic Advisory Corp.] will receive no additional remuneration from any person, broker, bank or other entity for this service. [First Atlantic Advisory Corp.'s] service will be covered entirely by the terms of the investment advisory contract which will be in accordance with the rules and regulations promulgated by the SEC regarding legal charges and methods of charging under investment advisory contracts. [First Atlantic Advisory Corp.'s] sole function would be limited to giving the order to effect the transaction which order would be based upon his discretion as to the types and amounts of securities to be bought or sold."*[14]

The SEC staff responded to First Atlantic's inquiry by stating that it would not be required to register as a broker-dealer for simply routing security transactions to a SEC broker or US bank for execution:

> *"Based on the foregoing, it appears that your characterization of the Corporation's proposed activities as those of an investment adviser is correct and, insofar as the Corporation is registered with the Commission as such, this Office would not recommend action to the Commission should the Corporation not register as a broker-dealer in securities."*[15]

Therefore, based on the guidance provided by the SEC staff in this line of no-action letters, if a non-U.S. registered investment adviser satisfies each of the three conditions above, it will not be obligated to register as a broker-dealer under the Exchange Act *solely* because it chooses to route its clients' orders to a registered SEC broker or to a U.S. bank for execution. Indeed, if each of the three conditions above are satisfied, routing clients' orders alone is not enough for the registered investment adviser to trigger broker-dealer registration with the SEC, i.e., there must be additional indicia of broker-dealer activity other than routing client orders to an SEC

---

[13] InTouch Global, LLC, (pub. avail. Nov., 14, 1995), Page 4.

[14] First Atlantic Advisory Corp., SEC Staff No-Action Letter (Feb. 20, 1974).

[15] Id.

This Press Release has been prepared by ML for general informational purposes only. It does not constitute legal advice, and is presented without any representation or warranty as to its accuracy, completeness or timeliness. Transmission or receipt of this information does not create an attorney-client relationship with ML. The contents of this presentation may constitute attorney advertising under the regulations of various jurisdictions including the State of New York.

broker-dealer to trigger registration.

B. Registered Investment Advisers Routing "Execution Only" Transactions

On a related note, ML often receives the inquiry whether registered investment advisers must also be registered as a broker-dealer with the SEC if they choose to route a single security order to a registered broker-dealer without first providing specific investment advice to the Client (i.e., a so-called "execution-only" transaction) regarding the trade.

Similar to all broker-dealer registration inquiries (as emphasized above), this is a fact based question which would require a closer examination of the adviser's entire business activities before reaching a definitive conclusion whether broker-dealer registration is mandated under the Exchange Act. For example, ML would want to know how often these "execution-only" transactions take place, i.e., does the adviser participate with any degree of regularity in routing such transactions or is this an isolated event? [16] Does the investment adviser receive any transaction-related compensation, directly or indirectly (or any other form of economic benefit), which is related to the transaction under review?

Importantly, as illustrated above, it is an absolute condition that an investment adviser must be "**engaged in the business**" of providing brokerage services before broker-dealer registration is mandated under the Exchange Act.[17] Said differently, an investment advisory firm cannot trigger broker-dealer registration with the SEC unless it is determined to be engaged in the brokerage business based on all relevant facts and circumstances surrounding the adviser's business.

Therefore, without knowing more, ML is of the view that the "engaged in the business" condition, as mandated under Section 3(a)(4) of the Exchange Act, would not be satisfied if the investment adviser fails to receive any transaction-related compensation for routing this so-called execution-only transaction to a registered broker-dealer and this type of security-routing activity does not take place with any degree of regularity or continuity, e.g., is a one-off transaction.[18]

---

[16] See Supra note 7 herein.

[17] Id.

[18] See InTouch Global, LLC, where the SEC staff stated the following: "*[I]f the securities activities are engaged in* ***for commissions*** *or other compensation* ***with sufficient recurrence*** *to justify the inference that the activities are part of the person's business, he will be deemed to be engaged in the business." (Emphasis added).*

The SEC staff in InTouch Global further stated: "*you should be aware that nothing in the above definitions would warrant a conclusion that a person is not engaged in the [brokerage] business merely because his securities activities are* ***only a small part of his total business activities****, or merely because his income from such activities* ***is only a small portion of his total income.*** *On*

This Press Release has been prepared by ML for general informational purposes only. It does not constitute legal advice, and is presented without any representation or warranty as to its accuracy, completeness or timeliness. Transmission or receipt of this information does not create an attorney-client relationship with ML. The contents of this presentation may constitute attorney advertising under the regulations of various jurisdictions including the State of New York.

In addition to the adviser conducting this "engaged in the business" analysis under the Exchange Act, ML is of the view that an SEC registered adviser must be primarily concerned with whether it has satisfied its duties and obligations to its clients under the Advisers Act when it routes these so-called "execution-only" orders to an SEC broker-dealer. For example, ML would be concerned whether the registered investment adviser has satisfied its fiduciary duty[19] to act in the best interest of its clients, by providing suitable investment advice, when it chooses to route an execution-only order to an SEC broker-dealer.[20] This concern under the Advisers Act should be thoroughly reviewed by the adviser and its U.S. legal counsel.

V. Conclusion

If any Non-U.S. Firm meets the definition of a broker-dealer as defined under the Exchange Act and the firm's brokerage activities make use of U.S. jurisdictional means, then the firm will be required to register as a broker with the SEC unless an exclusion or exemption is otherwise available or unless specific SEC guidance has confirmed that registration is not required.

* * * *

Dustin W. Milne
Managing Partner

If you have any questions regarding the U.S. broker-dealer registration requirements discussed herein, please do not hestitate to contact a member of Milne Legal.

contact@milnelegal.com

the contrary, if the securities activities are engaged in ***for commissions or other compensation*** *with* ***sufficient recurrence*** *to justify the inference that the activities are part of the person's business, he will be deemed to* ***be engaged in the business***." (Emphasis Added).

[19] See SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180 (1963) where the Supreme Court concluded that Section 206 imposes a fiduciary duty on all investment advisers to act in the best interest of their clients. See also, In re John G. Kinnard and Co., SEC No-Action Letter, 1973 WL 11848 (Nov. 1973).

[20] How to properly satisfy a registered investment adviser's duties and obligations under the Advisers Act is a separate analysis and beyond the scope of this article.

This Press Release has been prepared by ML for general informational purposes only. It does not constitute legal advice, and is presented without any representation or warranty as to its accuracy, completeness or timeliness. Transmission or receipt of this information does not create an attorney-client relationship with ML. The contents of this presentation may constitute attorney advertising under the regulations of various jurisdictions including the State of New York.