FESE AISBL
Avenue de Cortenbergh, 52 B-1000 Brussels
VAT: BE0878.308.670
Tel.: +32 2 551 01 80 – Fax : +32 2 512 49 05

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Response to the SEC's Request for Comments on the Proposed Amendments to Rule 15a–6

File No. S7–16–08

Exemption of Certain Foreign Brokers or Dealers

Introduction

FESE represents the European regulated exchanges engaged in equities, fixed income and derivatives. Europe's exchanges have supported the plans of the Securities and Exchange Commission (SEC) in the area of international cooperation from the start. FESE has written to the Commission twice in the last year, in August 2007 and June 2008, in order to express its members' support for mutual recognition in the securities field and their views on the optimal sequencing and coordination of the reforms under the SEC's consideration.

In line with these views, FESE supports the reform of Rule 15a-6 outlined in the Release, but believes that it should be complemented in the short run by **an exemptive relief for foreign exchanges** to be implemented **for the same category of investors** and **in the same timeframe** as the revision of Rule 15a-6. In addition, we urge that a **mutual recognition framework between the EU and the US** encompassing **stock exchanges** for **broader categories of investors** be established as soon as possible.

This stance is based on our assessment that the goal of improving the conditions for the US wholesale investors, firms and markets in the transatlantic market and fostering a streamlined globalization of securities markets requires more than the simple modernization of Rule 15a-6, as important and useful as it may be. Other, equally important reforms are needed to create a level playing field between the various venues on which orders are executed, i.e. between EU and US broker-dealers, between EU broker-dealers internalizing order execution and EU markets, and finally between US and EU markets. Without such a level playing field in the competition between these various entities, imbalances will lead to less efficient markets for the US investors with higher costs and less financial innovation.

In Part I below, we will focus in particular on one essential action the SEC could take in the wholesale area to complement its current action in the short run: creating **the opportunity for US broker-dealers to access foreign markets directly**, without the involvement of an additional broker-dealer. In Part II, we will provide detailed comments as well as answers to selected questions in the Release.

I. A Complementary Reform: Exemptive Relief for Exchanges

The EU is a major player in the world financial system and a key partner for the US. As the operators of Europe's regulated markets, Europe's exchanges have a very positive experience with transatlantic business and wish to foster further growth and efficiency in this market. As one example, long-standing no-action letter regimes operated by the Commodity Futures Trading Commission (CFTC), which are based on a regulatory/supervisory assessment (and are perhaps more akin to a mutual recognition framework than an exemptive relief), enable European future exchanges (and broker-dealers) to operate in the US, with proven benefits for the US investors and industry. In the area under SEC's jurisdiction, US investors invest in the EU markets via European broker-dealers (often affiliates of US broker-dealers) subject to Rule 15a-6. These trading flows account for an estimated 50% of the volumes currently executed on EU exchanges. Moreover, the largest US broker-dealers are established and active in the EU, accounting for a major share of the business. This picture underscores the fact that **the quality of Europe's markets and the competitiveness and efficiency of the transatlantic market** have a direct impact on the US investors and industry.

The **confidence shown by US investors in EU markets** derives from the quality and diversity of the instruments listed on our markets as well as the quality of the regulatory oversight. This is especially true after the consolidation and modernization of the EU's regulatory and supervisory framework under the

Financial Services Action Plan (FSAP), which created a state-of-the-art system of comprehensive oversight of investor protection and market integrity. Designed from 1999 to 2004, it is today fully implemented. In particular, operators of regulated stock exchanges are subject to a robust framework that regulates their initial and ongoing obligations regarding capital adequacy, robustness of systems, transparency of transactions, market integrity, and reporting. The EU regulatory framework with regard to exchanges is underpinned by the principle of competition, which allows all trading venues (exchanges, alternative trading systems operated by investment firms, and the banks' bilateral platforms for internalization) to compete with one another on an equal footing. Exchanges have fully embraced these reforms and are thriving in the face of greater competition. Moreover, the disclosure and market integrity rules applicable to **the financial instruments listed on EU regulated exchanges** and **the rules applicable to the regulated exchanges themselves** are such that **US investors are well protected when they purchase instruments on our markets.**

The SEC's proposed reform of Rule 15a-6 is rightly aimed at improving the conditions – globally, not just across the Atlantic – for wholesale US investors investing abroad. Currently, when US investors established in the US purchase instruments on EU exchanges, they are obliged to go through the intermediation **of two broker-dealers**, one on each side of the Atlantic, of which the European one only is allowed to become a member of the exchange.

Although the focus of the reform is on enabling the foreign broker-dealer to provide its services more efficiently, we note that the SEC pays special attention to improving **the conditions for the US broker-dealers** as well (pp. 97-105) and fostering **greater competition in the US** (pp. 105-108). We fully agree that these goals are important.

If Rule 15a-6 is reformed as proposed, the US investors will effectively be able to purchase such instruments with the intermediation of only one broker-dealer, **the foreign (European) one**. Allowing one intermediary to carry out this task will definitely improve the efficiency of the process. However, this reform would yield significantly **more benefits for the US investors and industry** if it was complemented by a further step which allowed **both of the two possible paths for investing abroad**, i.e. not only via **the foreign broker-dealer** but **also via the US broker-dealer**. Without such a reform, the only intermediary providing the service alone, i.e. without the unnecessary costs of a second entity, will be a foreign broker-dealer (with varying involvement of the US broker-dealer depending on type of exemption sought). A US broker-dealer would not be able to provide the cross-border service alone, because it would effectively not be able to become a member of a non-US exchange. Although US broker-dealers will benefit to some extent from certain lowered costs as highlighted in the consultation, they will not have the opportunity to offer the service on an equal footing with foreign competitors.

FESE supports improving the functioning of **both of the channels for US investments abroad**, through foreign and US broker-dealers. In the context of Europe, this will have benefits for the US and for the EU, because:

- **US broker-dealers** will be able to offer the same service as their foreign counterparts, involving only one intermediary in the chain, and have a fair chance at competition with the latter;
- **US investors** will have more diversified and competitive access to the EU markets;
- **US investors** will benefit from the greater liquidity and competitiveness of Europe's secondary markets in which they have a major stake due to their investment shares; and
- **EU exchanges**, which compete with the foreign broker-dealers in the EU market in most areas of their business including for order flow, will have a level playing field with these broker-dealers, which in turn will safeguard the efficiency, transparency and integrity of the EU markets.

EU exchanges have been advocating a reform along these lines for several years. With the conclusion of the FSAP, the reasons and the opportunities to implement it are even greater today. Moreover, the revision of Rule 15a-6 makes it more urgent since the US investors and industry will not derive **the full benefits of 15a-6 reform** in the wholesale area without this complementary reform.

This important reform to Rule 15a-6 should be followed by **mutual recognition for exchanges** as soon as possible which would involve the provision of access to **a broader category of investors**. Whereas

exemptive relief for foreign exchanges could immediately provide US broker-dealers with the ability to access foreign markets for the purpose of serving their wholesale clients (i.e. qualified investors), a mutual recognition framework could extend these services to other clients, provided that the conditions for mutual recognition agreed between the jurisdictions involved are fulfilled. We look forward to providing comments on future mutual recognition projects of the SEC.

Moreover, as globalization of securities markets accelerates, it is important that markets on both sides of the Atlantic can compete on **an equal footing** in order to allow for reduced costs and innovation to the benefit of investors, issuers and investment firms. A key element in this respect is the reform of the **current SEC exchange rule-filing process**. Although we are aware that the SEC has taken certain steps in this field, which have mainly resulted in interpretive guidance, some of our members think that allowing equal conditions in the competition among markets necessitates a more formal commitment to such a reform, including in particular changes to the scope of rules necessitating official filing and the scope of those subject to immediate effectiveness and the speed at which rules are approved.

Below we include more detailed remarks in relation to the questions posed in the Release. These comments are aimed at ensuring an efficient and clear regime and treating competing market participants in foreign jurisdictions such as Europe without discrimination.

II. Detailed Answers to the Questions

Investor Definition

We support the revision of the eligible investor category so as to include **natural persons** and to lower the threshold to **25 million USD**. From the perspective of European exchanges, this would be a positive development as it would access to brokerage services for a broadened set of investors buying and selling European products.

Regulation ATS

We understand that the SEC is considering allowing foreign broker-dealers exempted under Rule 15a-6 to also operate Alternative Trading Systems (ATSs). It is not entirely clear to us whether these ATSs would be trading European or US securities. In any event, we understand the Commission solicits comment on whether it should consider amending Regulation ATS to allow a foreign broker-dealer relying on an exemption in the proposed Rule 15a-6 to operate an ATS in the US so long as it otherwise complies with the terms of Regulation ATS. We **do not believe** that the SEC should deal with issues involving the operation of an ATS by foreign entities through amendments to Rule 15a-6. It would run counter to the SEC's policy goals not to afford more favorable regulatory treatment to broker-dealers than exchanges, so **the SEC should not provide this exemption to foreign broker-dealers until similar exemptive relief is available to exchanges through the mutual recognition initiative**. Otherwise, ATSs operated by foreign broker-dealers would have a **significant competitive advantage** over ATSs operated by exchanges. This would result in less competitive execution quality and higher costs for the investors in the long run.

Research

We support the changes. In addition, we think it needs to be clarified that **US broker-dealers can also distribute foreign research under the same conditions as foreign broker-dealers**. Research should also be seen within the context of a level playing field between US and foreign broker-dealers. The proposed Rule itself underlines the importance of the distribution of research when stating that "broker-dealers often provide research to the customers with the expectation that the customer eventually will trade through the broker-dealer". Therefore a regime of equal opportunities should also encompass the subject of research.

Definition of "foreign securities"

We support the proposed changes to the exemption for foreign broker-dealers soliciting trades from US qualified investors. However, the definition of "**foreign private issuer**" (in the context of defining a "foreign security") as proposed is not workable, in our view. This definition includes subjective elements and there is no definitive list of such securities that can be relied upon for compliance purposes.

As one possible practical solution, we suggest that a "foreign security" be considered to fall under this definition based on **whether the securities are listed on a non-US exchange which is a member of the World Federation of Exchanges**. This is a simpler, objective standard that will work from a compliance perspective. It would be very cumbersome and inefficient to assess, for each security, the four factors set forth in Rule 405. Automated systems cannot make these judgments easily. In addition, the process of manually collecting the information in order to make these judgments would be overly burdensome.

Options exchanges

We support the changes applicable to options exchanges, which are a welcome step towards greater efficiency and choice for US investors. The existing no-action letter regime for foreign equity derivatives has served an important function since its inception. Its codification would provide **additional clarity.** The **extension of the eligible investor category** to qualified investors would be of benefit. Moreover, we fully agree with and support the SEC's statement that **US investors would benefit from accessing options exchanges' OTC services.**

However, the existing no-action letter regime for foreign equity derivatives is restrictive as it offers the options exchanges the possibility only to ***familiarize*** **US investors with foreign products.** This limitation in effect **restricts the ability of US investors to access high-quality foreign options markets operated by exchanges.** Moreover, there is **a regulatory anomaly** in this situation from the perspective of the protection of US investors: Whereas the foreign broker-dealers can carry out transactions on **all** foreign options – both on-exchange and OTC derivatives **– the foreign exchanges, whose options are subject to higher disclosure and transparency standards and traded and cleared on an organized basis,** do not have the right to connect US members to their systems or solicit investors. The current proposal would not change this basic premise.

For these reasons, we believe that the SEC should not set a simple codification as its ultimate goal. The target should be to allow options exchanges to solicit business with US qualified investors in the same manner as non-US broker-dealers can. An important element of that would be **to allow US broker-dealers to have direct screen access to these exchanges from locations in the US**. In line with our views in Part I (which calls for allowing US broker-dealers to become members of EU exchanges in relation to all instruments), foreign options exchanges should be able to **connect US broker-dealers** to their markets without triggering onerous registration requirements. Moreover, the currently proposed reform should be designed in such a way as to **remove all unnecessary restrictions on US investors** when getting connected to high-quality organized options markets abroad.

Therefore, we believe that the reforms in this area should be strengthened in the following ways:

1. Familiarization activities should be available to **all broker-dealers**, and not just members of exchanges;
2. Any regime imposing **experience conditions** on US qualified investors to trade options on foreign markets should be the same for OTC and listed options (if indeed not more lenient in the case of listed options, which by definition provide greater investor protection);
3. A foreign exchange should be permitted to provide investors with **a list of its members without the investor first asking for it;**
4. For the important reasons outlined in Part I and above, it should be clarified that foreign options exchanges are able to provide **direct market access from locations in the US to broker-dealers** that are their members; and
5. Finally, the SEC should move swiftly to **amend its rules under the Securities Act** as they affect options so as to allow US investors to enjoy the benefits of a reformed Rule 15a-6 for trading all foreign securities.

III. Conclusion

In summary, we **welcome the SEC's current initiative to improve the functioning of Rule 15a-6**, which will have the effect of increasing wholesale business in the transatlantic marketplace. However, we urge the SEC **to take additional important steps that will complement this reform,** in particular in the form of establishing **in the short term an exemptive relief regime for foreign exchanges**.

As soon as possible thereafter, we strongly encourage the SEC **to establish mutual recognition for stock exchanges that would apply to broader investor categories**.

In addition, while we support most of the specific proposals in the Release, we recommend revisions **to the Options Exchanges section** that would allow US qualified investors to derive greater benefits from the reform by accessing high-quality foreign options exchanges in a **more direct and streamlined fashion.**

Moreover, we advise the SEC **not to tackle issues involving the operation of an ATS by foreign entities through amendments to Rule 15a-6** and in any event, for competition reasons, caution against providing an exemption to foreign broker-dealers to operate an ATS **until similar exemptive relief is available to exchanges** through the mutual recognition initiative.

We wish to express our appreciation for the opportunity to comment on this important reform and look forward to future opportunities to contribute to the SEC's proposals.