Regulation of Non-U.S. Exchanges' Marketing Efforts in the United States

Published by the Broker-Dealer & Investment Management Regulation Group
September 2011

The following discusses the application of the federal and state securities laws to marketing calls, print advertisements, and Internet communications by a non-U.S. exchange to potential investors in the United States.

I. Background

The federal securities laws generally require the registration of any securities exchange doing business in the United States by means of interstate commerce.[1] Under Section 5 of the Exchange Act, an exchange[2] is required to register with the SEC as a "national securities exchange" if it:

[1] The federal securities laws also require the registration of any broker-dealer effecting securities transactions, or of any security offered or sold to the public, by means of interstate commerce.

Section 15(a) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), makes it unlawful for a "broker" or "dealer" to make use of the mails or any means or instrumentality of interstate commerce "to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security" unless such person is registered with the Securities and Exchange Commission ("SEC" or the "Commission") as a broker or dealer. The terms "broker" and "dealer" are defined under Sections 3(a)(4) and (5) of the Exchange Act to mean any person engaged in the business "of effecting transactions in securities for the account of others" or "of buying and selling securities for his own account," respectively, and are not limited to U.S. persons.

Section 5 of the Securities Act of 1933, as amended (the "Securities Act"), makes it unlawful for any issuer, foreign or domestic, to make use of any means of interstate commerce to "offer or sell" a security unless a registration statement has been filed with respect to the security and the transaction is accompanied or preceded by a prospectus which complies with Section 10 of the Securities Act. The terms "offer" and "sell" are broadly defined in Section 2(a)(3) of the Securities Act to include any attempt to dispose of a security.

The various states' securities laws (referred to as the "Blue Sky laws") regulate securities transactions within their jurisdictions and, unless an appropriate exemption is available, require, among other things, (i) the registration as a broker-dealer of any person effecting securities transactions for other persons, and (ii) the registration of the securities being sold.

[2] The term "exchange" is broadly defined under Section 3(a)(1) of the Exchange Act to include:

Kathy H. Rocklen
212.969.3755 — krocklen@proskauer.com

Benjamin J. Catalano
212.969.3980 — bcatalano@proskauer.com

> make[s] use of the mails or any means or instrumentality of interstate commerce for the purpose of using any facility of an exchange within or subject to the jurisdiction of the United States to effect any transaction in a security or to report any such transaction.

The term "exchange" is not limited to a U.S. person. And the term "interstate commerce" is broadly defined to include trade, commerce, transportation or communication, by whatever means, between any foreign country and any state or territory of the United States. Therefore, the registration provisions of Section 5 apply to any foreign exchange that makes use of the telephone, mails, the Internet or any other means or instrumentality of interstate commerce to use the facilities of the exchange to effect transactions or report trades.[3] On the other hand, Section 5 generally should not require the registration of a non-U.S. exchange that merely uses the means of interstate commerce to advertise its marketplace and its facilities are not used by U.S. persons to trade or report exchange listed or other securities.

The SEC historically has taken a "territorial" approach to the registration provisions of the federal securities laws.[4] In this regard, the Commission normally would require the registration of an exchange physically present

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> Any organization, association, or group of persons, whether incorporated or unincorporated, which constitutes, maintains, or provides a marketplace or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange as that term is generally understood, and includes the marketplace and the market facilities maintained by such exchange.

[3] The federal and state registration provisions would also apply to any member broker-dealer that effects transactions for, or to any exchange listed issuer that offers or sells securities to, U.S. persons by the same means of interstate commerce.

[4] The SEC has taken a broader, "jurisdictional" approach to other aspects of the federal securities laws, including the anti-fraud provisions of Section 10(b) and Rule 10b-5 of the Exchange Act. The SEC has noted that U.S. courts "have recognized jurisdiction over fraudulent conduct where substantial *conduct* or *effects* occur in the United States." (emphasis added) The states have taken the same approach to the application of the Blue Sky laws, extending their reach to any securities professionals "doing business in the state." However, in *Morrison v. Nat'l Austl. Bank Ltd.,* 130 S. Ct. 2869 (2010), the U.S. Supreme Court specifically disregarded the "conduct and effects" test. In *Morrison*, the Supreme court assumed subject matter jurisdiction in the federal courts over all cases under Section 10(b) and Rule 10b-5 and measured the reach of these provisions over foreign actors based on the express language of the provision to hold that there is no cause of action where the securities are not purchased in the United States. Section 929P of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ostensibly overturns *Morrison* in that it expressly provides for federal court jurisdiction over SEC enforcement actions where there is "(1) conduct within the United States that constitutes significant steps in furtherance of the violation; or (2) conduct occurring outside the United States that has a foreseeable and detrimental effect within the United States." The amendment essentially codifies the SEC's conduct and effects test. However, since the amendment does not address the substance of Section 10(b) of the Exchange Act (or the other anti-fraud provisions of the securities laws), upon which the holding in *Morrison* is based, it is unclear what effect it will have in broadening the reach of Section 10(b). This new provision has not yet been applied by the courts.

In addition, the "Due Process" clause under the 14th Amendment of the U.S. Constitution puts limits on the jurisdiction of the federal government and the states over the activities of foreign persons. *See International Shoe Co. v. State of Washington*, 66 S. Ct. 154 (1945); *McGee v. International Life Ins. Co.*, 78 S. Ct. 199 (1957); *Hanson v. Denkla* 78 S. Ct. 1228 (1958) (Although these cases deal with jurisdiction in one state over the activities of persons in another state, the same principles apply to jurisdiction of the federal government over activities of persons outside the United States.)

In *International Shoe*, the Court held that:

> due process requires only that in order to subject a defendant to a judgment *in personam*, if he be not present within the territory of the forum, he have certain minimum contacts with it such that the maintenance of the suit does not offend 'traditional notions of fair play and substantial justice.'

66 S. Ct. at 158. In *Hanson*, the Court went on to qualify further the activities in the forum territory that may lawfully submit the out-of-state defendant to jurisdiction of the courts.

> [I]t is essential in each case that there be some act by which the defendant purposefully avails if of the privileges of conducting activities within the Forum State, thus invoking the benefits and protections of the laws.

78 S. Ct. at 1239.

We have not identified any decision by the U.S. Supreme Court to uphold the jurisdiction of the federal government or a state over a foreign person that merely solicits services to be provided outside the United States. On the other hand, the Supreme Court has

in the United States or using the telephone, the mails, the Internet or any other means of interstate commerce to provide U.S. persons with access to its trading systems or other facilities of the exchange to effect or report transactions. But it should not necessarily require registration of a foreign exchange for having representatives present in the United States or for using the means of interstate commerce for purposes other than the effectuation of trades or trade reporting, including direct marketing, print advertising or the provision of information over the Internet with respect to these services that are offered outside the United States. However, the non-U.S. exchange also must be careful to avoid being characterized as a "broker or dealer" subject to registration under Section 15(a) of the Exchange Act for inducing the purchase or sale of securities by U.S. persons.[5]

A non-U.S. exchange's marketing activities also may affect the U.S. registration status of exchange members or other participating organizations or the companies listed on the exchange. Any marketing or advertising activities on behalf of a participating organization in the United States may be considered an "attempt to induce the purchase or sale of [securities]," requiring registration of the organization under Section 15(a). Similarly, any marketing efforts in the United States by a non-U.S. exchange on behalf of a foreign issuer engaged in the distribution of securities outside the U.S. may be considered an "offer to sell" the securities in the U.S. subject to registration under Section 5 of the Securities Act. The same marketing activities on behalf of a foreign issuer, if conducted in a public forum, could be considered a "public offering," "general solicitation" or "directed selling efforts" destroying any exemption from registration available under Section 4(2) of the Securities Act, or Regulation D or Regulation S under the Securities Act. Marketing by a non-U.S. exchange that mentions the exchange's participating organizations or listed companies may be considered marketing efforts by the participating organizations and listed companies themselves.

The various state Blue Sky laws generally do not require registration of a securities exchange located outside the state. However, the states may seek to obtain jurisdiction over any person or entity, including a foreign exchange that facilitates the offer or sale of securities to residents in the state.

Relevant provisions of the federal securities laws, state Blue Sky laws and the rules and regulations promulgated thereunder, determine the kinds of marketing initiatives a non-U.S. exchange may implement in the United States without requiring registration of the exchange, its participating organizations or listed companies. The SEC and the North American Securities Administrators Association ("NASAA") have provided some guidance in this regard.

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ruled that mere solicitation of business in a state by a foreign corporation not physically present there, without more, is insufficient to confer jurisdiction over the corporation, albeit in older cases. *See People's Tobacco Co. Ltd. V. American Tobacco Co.*, 38 S. Ct. 233, 235 (1918); *International Harvester Co. v. Kentucky*, 34 S. Ct. 947, 948 (1914); *Green v. Chicago, Burlington & Quincy R. Co.*, 27 S. Ct. 595, 596 (1907). It should not matter that representatives of the corporation are physically present in the state for purposes other than providing such services. *See Rosenberg Bros. & Co. v. Curtis Brown Co.*, 43 S. Ct. 170, 171 (1923).

[5] Several foreign exchanges requested SEC no-action relief from, among other things, the broker-dealer registration provisions of the Exchange Act to maintain representative offices in the United States and to conduct certain marketing activities with respect to unregistered securities traded on the exchanges. These letters have been limited to the marketing of option products, which, by their nature, are in continuous distribution. *See Tokyo Stock Exchange* (pub. avail. July 27, 1999); *Mercato Italiano dei Derivati* (pub. avail. Sept. 1, 1998); *Societe de Compensation des Marches Conditionnels* (pub. avail. June 17, 1996); *Hong Kong Futures Exchange Limited – Hang Seng Index Options* (pub. avail. Sept. 26, 1995); *The London International Financial Futures Exchange and The London Traded Options Market* (pub. avail. May 1, 1992).

The SEC staff agreed not to recommend enforcement of the broker-dealer registration provisions of the Exchange Act provided the exchanges (i) limit their marketing to "eligible" broker-dealers and institutions, (ii) do not engage in general advertising with respect to unregistered securities and (iii) do not give investment advice, make recommendations, take or direct orders on behalf of the exchange or participating organizations with respect to the securities, in the United States. An eligible broker-dealer or institution must be a "qualified institutional buyer" as defined in Rule 144(a)(1) under the Securities Act or an international organization, such as the United Nations or International Monetary Fund, excluded from the definition of "U.S. person" in Rule 902(k)(2)(vi) of Regulation S under the Securities Act.

The following addresses various means of marketing in the United States and procedures by which a non-U.S. exchange, its participating organizations and listed companies may avoid triggering U.S. registration requirements.

A. Direct Marketing

A non-U.S. exchange should adhere to the following procedures while engaging in sales calls, conferences, teleconferences, or advertising by mail in the United States:

1. All direct marketing programs, whether they are conducted orally or in writing, should make clear that non-U.S. exchange's services are not available to persons in the United States, except as may be permitted through a U.S. registered broker or dealer.
2. The exchange should limit any direct marketing programs to U.S. registered broker-dealers and qualified institutional buyers as defined in Rule 144A(a)(1) under the Securities Act.
3. A direct marketing program ordinarily should not identify a non-U.S. exchange member or other participating organization of the exchange. (Nevertheless, the exchange should be able to describe the characteristics of participating organizations in general.)
4. A direct marketing program ordinarily should not discuss an exchange listed issuer or security if the issuer is involved in a distribution (inside or outside the United States). (In certain circumstances the name of a company in distribution may be included in an index or among a substantial number of other companies in the same industry and mentioned no more prominently than the others.)
5. A direct marketing program should not contain any investment advice or recommendation with respect to an exchange listed issuer or security. No exchange representatives should accept or direct orders in listed securities for or to the exchange or any participating organization. (It should be permissible for the exchange to provide a list of all participating organizations and their U.S. registered broker-dealer affiliates at the request of a U.S. registered broker-dealer or qualified institutional buyer.)

B. Print Media

The same principles apply to advertisements in print media in the United States, except that a non-U.S. exchange should be able to identify the names of participating organizations and listed companies in advertisements in publications with no general circulation in the United States.[6] A non-U.S. exchange should consider implementing the following procedures with respect to advertisements in print media:

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[6] Rule 902(c)(1) of Regulation S under the Securities Act defines the term "directed selling efforts" to include, among other things, "placing an advertisement in a publication 'with a general circulation in the United States.'" Conversely, placing an advertisement in a publication *without* a general circulation in the United States would not be considered directed selling efforts in the United States, and, therefore, should not subject an offer of securities mentioned in the advertisement to registration under the Securities Act.

> Rule 902(c)(2) of Regulation S provides that:
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> a Publication "with a general circulation in the United States":
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> (i) Is defined as any publication that is printed primarily for distribution in the United States, or has had, during the preceding twelve months, an average circulation in the United States of 15,000 or more copies per issue; and
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> (ii) Will encompass only the U.S. edition of any publication printing a separate U.S. edition if the publication, without considering its U.S. edition, would not constitute a publication with a general circulation in the United States.

For example, *Institutional Investor*, published in the U.S. by Institutional Investor, Inc., is a financial services trade magazine with a general circulation in the United States. *Euromoney*, published primarily for distribution in Europe and Asia by Euromoney Institutional Investor PLC, has a limited circulation of approximately 6,500 copies in the U.S., and, therefore, would not be considered as having a general circulation in the United States.

1. All print advertisements that appear in a publication with a general circulation in the United States should contain a legend or other disclaimer to the effect that the exchange's services are not available to persons in the United States except through an appropriately registered broker or dealer.
2. No non-U.S. exchange member or other participating organization should be identified in any print advertisement that appears in a publication with a general circulation in the United States.
3. No non-U.S. exchange listed issuer or securities should be identified in any print advertisement that appears in a publication with a general circulation in the United States. (The advertisement could, however, identify the name of a company if it is included in a broad-based index or otherwise among a substantial number of other companies and not mentioned more prominently than the others.)

C. Electronic Media

The Internet and other related technologies present special problems in determining the extraterritorial effect of U.S. securities laws. In March 1998, the SEC issued a release elaborating on the application of the registration provisions of the federal securities laws to non-U.S. persons offering securities or investment services through offshore web sites.[7] In the release, the SEC affirmed that the Internet is an instrumentality of interstate commerce sufficient to invoke the jurisdiction of the federal securities laws, and that an exchange or other market participant is subject to registration and regulation by the Commission where any relevant securities activity over the Internet takes place "in the United States." In this regard, the Commission noted that registration depends on whether the Internet content is targeting U.S. persons.

> We would not view issuers, broker-dealers, exchanges, and investment advisers that implement measures that are reasonably designed to guard against sales or the provision of services to U.S. persons to have targeted persons in the United States with their Internet offers. Under these circumstances, Internet postings would not, by themselves, result in a registration obligation under the U.S. securities laws.[8]

What constitutes adequate measures will depend on the facts and circumstances. However, the SEC has provided guidance for exchanges, broker-dealers and issuers to avoid triggering U.S. registration requirements.[9]

With regard to a non-U.S. exchange's web site, the SEC noted that it would not require registration if the web site were (i) to advertise the exchange generally, (ii) to disseminate quotations, or (iii) to allow orders to be directed to the exchange for execution, provided the exchange takes reasonable steps to prevent U.S. persons

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Similarly, the *Financial Times'* U.S. edition is a publication with a general circulation in the United States, but the business newspaper's non-U.S. editions have no official U.S. circulation.

The same principle should apply to an advertisement that mentions an exchange member or participating organization in a publication without a general circulation in the United States. Although Regulation S does not affect the broker-dealer registration provisions under Section 15(a) of the Exchange Act, the advertisement should not constitute a solicitation by the broker-dealer "in the United States," which would destroy the unsolicited transaction exemption under Rule 15a-6 under the Exchange Act, unless the advertisement has a content which can reasonably be construed as directly targeting U.S. investors.

[7] International Series Release No. 1125 (Mar. 23, 1998) ("Release No. 1125").

[8] *Id.*

[9] The SEC staff also agreed not to recommend enforcement action against derivatives exchanges Eurex and LIFFE if they did not register with the Commission as national securities exchanges (and exchange participants did not register as broker-dealers) in connection with the display in the U.S. of quotations for the offer and sale of equity and index options provided that the parties deal with qualified U.S. institutional investors only in accordance with Rule 15a-6 under the Exchange Act, principally through U.S. registered broker-dealers. *See Eurex Deutschland*, SEC No-Action Letter (Jul. 27, 2005); *London Int'l Financial Futures Exchange*, SEC No-Action Letters (May 1, 1992, Mar. 6, 1996).

from directing orders to the exchange through the site. Some steps that the Commission identified as reasonably designed to prevent U.S. investors from directing orders to a foreign exchange include the following:

- Posting a disclaimer on the web site stating that the exchange's services are not directly available to U.S. persons, or specifying the jurisdictions (other than the United States) in which those services are available;
- Requiring market participants that trade through the web site to identify their country of residence and mailing address;
- Implementing procedures to prevent exchange trading through the web site by any person that the exchange has reason to believe is a U.S. person based on the information provided; and
- Implementing procedures to prevent arrangements by members to provide U.S. persons with access to the exchange over the Internet indirectly through the member.[10]

NASAA issued a similar interpretation on the Internet activities of securities professionals.[11]

A foreign exchange that does not provide direct execution services through its web site, or access to members with links to the exchange, would reduce the possibility that it would have to register in the United States.[12]

A non-U.S. exchange should consider implementing the following procedures with respect to its web site:

1. The web site should contain a disclaimer on or easily accessible from the home page substantially as follows:

NOTICE TO U.S. PERSONS

No statement made herein should be construed as a solicitation to buy or sell any security or other financial instrument through the facilities of the exchange. Offers to buy or sell securities or to provide financial services to U.S. residents may be made only by persons who are appropriately registered as brokers, dealers or investment advisers with federal and state regulatory authorities in the United States and its territories and possessions, and only in those jurisdictions in which the securities are registered, unless an exemption from registration is available for the broker, dealer or investment adviser and the particular type of transaction or product involved. Contact your broker, dealer or investment adviser in the United States for more information.

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[10] Furthermore, if a participating organization or listed company uses a foreign exchange's web site to promote its services, it is incumbent upon the participating organization or listed company to ensure that the exchange's web site contains at least the same precautions against sales of securities to U.S. investors as would be required if the participating organization or listed company used its own web site. *See* Release No. 1125 for a discussion of procedures with respect to non-U.S. broker-dealers' and issuers' web sites.

[11] NASAA, an organization of state and provincial securities regulators, issued an interpretive statement concerning securities professionals using the Internet to disseminate information on products and services. In general, the interpretive statement requires that any broker-dealer, investment advisor or agent using the Internet Web Site to distribute information on securities or investment services must (i) post a disclaimer to the effect that offers or sales in the state require the registration, or exemption from registration, of the market participant; (ii) implement technical "fire walls" or other policies and procedures reasonably designed to ensure registration in the state, or exemption from registration, prior to communicating directly with customers in the state, and (iii) limit the Web Site to general information on products and services not intended to solicit securities or investment services.

The NASAA interpretive statement addresses the same concerns as the SEC's March 1998 release on offshore Internet Web Sites: out-of-state securities professionals conducting business over the Internet must acknowledge the states' registration requirements and limit the content of their Web Sites to avoid the unauthorized solicitation of securities or investment services in the states. NASAA's statements are not binding on its members and states may adopt more or less restrictive positions.

[12] Most non-U.S. exchange markets do not provide direct trading access to potential investors. Some foreign exchanges that host electronic trading systems usually permit access through approved member firms only. In most instances, the foreign exchange provides a list of its approved members with trading capabilities, and hyperlinks to their respective web sites, if available.

2. For non-U.S. exchange members or other participating organizations and listed companies whose securities are not interlisted with a U.S. exchange, the web site should prevent access to hyperlinks to such members or listed companies by U.S. residents, either by requiring the viewer to enter his or her address for screening, or by including a password system designed to prevent access by U.S. persons. Interlisted companies, which are necessarily U.S. reporting companies, may be given the choice of being on the password-protected page, since it is reasonable to expect that their web sites comply with U.S. securities law requirements.
3. A non-U.S. exchange should impose the same residence information requirement or password protection before permitting users to view any page describing recent or upcoming public offerings by exchange listed issuers. (An undertaking may be obtained from all issuers stating that they will inform the exchange of all distributions and related information.)

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Please do not hesitate to contact us if you have any questions regarding the material discussed herein.