

INFORMATIONAL

Conduct Of Business Abroad

NASD Provides Interpretive Guidance On The Conduct Of Business Abroad

SUGGESTED ROUTING

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- Legal and Compliance
- Operations
- Registration
- Senior Management

KEY TOPICS

- Business Abroad

Executive Summary

The National Association of Securities Dealers, Inc. (NASD®) is issuing this *Notice to Members* as part of its continuing effort to provide members with guidance on complying with rules that govern their business in foreign locations. The NASD also reminds members and persons associated with members considering doing business in foreign jurisdictions of their obligations to comply with the applicable U.S. and foreign laws.¹

Questions concerning this *Notice* should be directed to: Grace Yeh, Assistant General Counsel, Office of General Counsel, NASD Regulation, Inc. (NASD Regulation), at (202) 728-6939, or Kyra Armstrong, Senior Attorney, Department of Member Regulation, at (202) 728-6962.

Discussion

The NASD has rules that apply to U.S.-based member firms conducting business in foreign locations, to member firms based in other countries that do business in the United States, and to foreign representatives who wish to engage in securities business in the U.S. Collectively, these rules and programs make it easier for NASD members to conduct business abroad. These rules include the following:

- The NASD permits firms to register certain persons working in foreign offices as Foreign Associates without requiring qualification examinations (*NASD Rule 1100*).
- The NASD authorizes member firms to maintain registrations for persons who are engaged

in the investment banking or securities business of a foreign securities affiliate or subsidiary (*NASD Rules 1021(a) and 1031(a)*).

- The NASD allows, in limited circumstances, member firms and persons associated with a member to pay transaction-related compensation to non-registered foreign persons, or foreign finders (*NASD Rule 1060(b)*).
- The NASD permits persons registered in certain foreign countries to work in the U.S. as general securities representatives after taking an abbreviated examination (*NASD Rule 1032*).

The NASD also offers examinations and continuing education programs abroad.

In addition, the NASD has issued previous *Notices to Members* that provide guidance concerning the conduct of business abroad. For example, in *NASD Notice to Members 98-91*, the NASD alerted members to their obligations with respect to cold calling and advertising to persons in the United Kingdom. In *NASD Notice to Members 00-02*, the NASD reminded members and persons associated with members of their obligations to comply with applicable U.S. laws and foreign laws when soliciting business in any foreign jurisdiction.

In order to further facilitate member firms' awareness and understanding of their responsibilities, the NASD has prepared answers to the following frequently asked questions concerning the conduct of business abroad.

Questions And Answers

I. Foreign Associates

Q 1. Who may be designated a Foreign Associate?

A. Under NASD Rule 1100, a Foreign Associate is an individual who is not a citizen, national, or resident of the United States or any of its territories or possessions. A Foreign Associate cannot engage in securities activities with or for any resident, citizen, or national of the United States. This person may engage in securities activities for the member firm outside the jurisdiction of the United States only.

Q 2. What is the scope of permissible business activity for a Foreign Associate?

A. A Foreign Associate must be registered with the NASD and will be deemed an associated person or employee of the member. A Foreign Associate may act in any registered capacity on behalf of the member, consistent with their designation as a Foreign Associate. This can include acting as a general securities representative or trader. See *Notice to Members 95-37*. The limited supervisory functions that can be properly delegated to general securities representatives also may be assigned to Foreign Associates. However, the NASD rules do not permit Foreign Associates to perform functions that require principal registration, e.g., serving as the office supervisor for an

Office of Supervisory Jurisdiction. As always, ultimate supervisory responsibility for every registered and unregistered branch office must be assigned to one or more appropriately registered principals.

Q 3. Does a Foreign Associate have to take any U.S. qualifications examinations?

A. No. Under NASD Rule 1100, Foreign Associates are exempt from the requirement to pass a qualification examination.

Q 4. Does a Foreign Associate have to register?

A. Yes. Under NASD Rule 1100, all persons associated with a member who are designated as Foreign Associates are required to be registered with the NASD.

Q 5. How does a firm register a Foreign Associate?

A. Before a member can classify a person as a Foreign Associate, it must:

- file a form designated "Application for Classification as a Foreign Associate" (Form U-4 is currently used) with the NASD and certify that the person meets the criteria for Foreign Associate;
- attest that the person is not disqualified from registration;
- certify that service of process for any proceeding by the NASD for such person may be sent to an address designated by the member; and

- submit a Form U-4 through the Central Registration Depository (CRD) system to request registration as a Foreign Associate on behalf of an individual.

The member must notify the NASD immediately if the Foreign Associate is terminated by filing a Form U-5.

II. Foreign Finder

Q 6. What is a foreign finder, and in what capacity may a foreign finder act on behalf of a member firm?

A. Foreign finders are non-registered foreign persons who refer non-U.S. customers to a member firm. Because foreign finders are not considered associated persons of a member, the sole involvement of a foreign finder in the business of a member firm is the initial referral of non-U.S. customers to the firm. See *Notice to Members 95-37*.

Q 7. May a member pay finders' fees to foreign finders?

A. Yes. NASD Rule 1060(b) provides that member firms and persons associated with a member may pay transaction-related compensation to foreign finders, based upon the business of customers such persons direct to member firms ("foreign finder exemption"). See *Notice to Members 95-37*.

NASD Rule 1060(b) states that for the foreign finder exemption to apply, the member firm must assure itself that the foreign finder receiving

the compensation neither is required to register in the U.S. as a broker/dealer nor is subject to a disqualification as defined in Article III, Section 4 of the NASD's By-Laws and must further assure itself that the compensation arrangement does not violate applicable foreign law.

The following conditions must also be met:

- the finder must be a foreign national (not a U.S. citizen) or a foreign entity domiciled abroad;
- the customers are foreign nationals (not U.S. citizens) or foreign entities domiciled abroad transacting business in foreign or U.S. securities;
- the customers must receive a descriptive document, similar to that required by Rule 206(4)-3(b) of the Investment Advisers Act of 1940, that discloses what compensation is being paid to finders;
- the customers must provide written acknowledgement to the member firm of the existence of the compensation arrangement and it must be retained and made available for inspection by the NASD;
- records reflecting payments to finders must be maintained on the member firm's books and the actual agreements between the member firm and persons compensated must be available for inspection by the NASD; and
- the confirmation of each transaction must indicate that a referral or finders' fee is being paid pursuant to an agreement.

III. Maintenance Of Registrations While Working Abroad

Q 8. Can persons working for U.S. broker/dealers maintain their registrations while working abroad?

- A. Yes. *NASD Rules 1021(a) and 1031(a)* permit members to maintain individual registrations as a principal or representatives, as applicable, for persons who are engaged in the investment banking or securities business of a foreign securities affiliate or subsidiary of the member.
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IV. Foreign Members

Q 9. What is a foreign member?

- A. NASD Rule 1090 defines a foreign member as a member firm that does not maintain an office in the U.S. responsible for preparing and maintaining financial and other reports required to be filed with the Securities and Exchange Commission (SEC) and the NASD.
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Q 10. What special obligations must a foreign member perform?

- A. Under NASD Rule 1090, a foreign member must:
- prepare all reports required to be filed with the SEC and the NASD and maintain a general ledger chart of account and any description thereof, in English and U.S. dollars;
 - reimburse the NASD for any expenses incurred in connection with the examinations of the member to the extent such expenses exceed the cost of examining

a member located within the continental U.S. in the geographic location most distant from the District Office of appropriate jurisdiction;

- ensure the availability of an individual fluent in English and knowledgeable in securities and financial matters to assist representatives of the NASD during examinations; and
- utilize, either directly or indirectly, the services of a broker/dealer registered with the SEC, a bank or clearing agency registered with the SEC located in the U.S. in clearing all transactions involving members of the NASD, except where both parties to a transaction agree otherwise.

V. Supervision And Inspection Obligations Of Member Firms With Foreign Offices

Q 11. What level of supervision is required in foreign offices?

- A. Foreign offices of member firms must comply with the same rules of supervision as U.S. locations pursuant to NASD Rule 3010. *See Notice to Members 99-45.*

Member firms must supervise all of their associated persons, regardless of location, compensation or employment arrangement, or registration status, in accordance with the NASD By-Laws and rules. *See Notice to Members 98-38.* Both the SEC and NASD have emphasized that small, dispersed offices need close attention and supervision. *See In re Royal Alliance Associates Inc., Release No. 34-38174 (Jan. 15, 1997); Notice to Members 98-38.*

Q 12. What is a branch office?

A. A branch office generally is defined in NASD Rule 3010(g)(2) as any location identified by any means to the public or customers as a location where an investment banking or securities business is conducted, subject to certain exclusions set forth in NASD Rule 3010(g)(2).

Pursuant to Article IV, Section 8 of the NASD By-Laws, the NASD must be advised of the opening or closing of any branch office within 30 days of the opening or closing. Such notice must be filed with the NASD on Schedule E to Form BD. See *Notice to Members 88-51*.

Q 13. What is an Office of Supervisory Jurisdiction (OSJ)?

A. An OSJ is defined in *NASD Rule 3010(g)(1)* as any office of a member at which any of the following activities take place:

- order execution and/or market making;
- structuring of public offerings or private placements;
- maintaining custody of customers' funds and/or securities;
- final acceptance (or approval) of new accounts on behalf of a member;
- review and endorsement of customer orders;
- final approval of advertising or sales literature for use by persons associated with the member; or

- responsibility for supervising the activities of persons associated with the member at one or more other branch offices of the member.

Under NASD Rule 3010(a)(4), every OSJ must have a registered principal located at the office. Foreign associates are not allowed to act in a registered principal capacity.

Q 14. Must foreign offices be registered?

A. Yes. All branch offices and OSJs, regardless of their location, must be registered with the NASD. Any location at which a member is conducting a securities business that does not fall within the definition of an OSJ or a branch office can be referred to as an "unregistered office." While "unregistered offices" do not have to be registered with the NASD, member firms should keep a list of and supervise such offices.²

Q 15. Must firms inspect foreign offices?

A. Yes. Firms must inspect all offices regardless of their location. Unregistered offices must have regularly scheduled inspections. Branch offices must have cyclical inspections and OSJs must have annual inspections. See *In re Royal Alliance Associates Inc., Release No. 34-38174 (Jan. 15, 1997)* (where the SEC stated that it harbored grave doubts that a practice of conducting a pre-announced compliance examination only once a year would necessarily discharge the supervisory

obligations of any firm that incorporates a structure in which smaller offices are operated by only one or two representatives); *Notice to Members 99-45: NASD Rule 3010*.

Q 16. Are firms required to supervise independent contractors?

A. Yes. Independent contractors performing investment banking or securities services for a member firm are considered associated persons. See *Notice to Members 98-38*. Irrespective of an individual's location or compensation arrangements, all associated persons must be supervised by the firm with which they are registered. See *Notice to Members 86-65*. The fact that an associated person conducts business at a separate location or is compensated as an independent contractor does not alter the obligations of the individual and the firm to comply fully with all applicable regulatory requirements. See *Notice to Members 86-65*.

VI. NASD Inspections**Q 17. Are foreign offices subject to inspections by the NASD?**

A. Yes. Member firms with offices located outside the United States are assigned to an NASD District Office for purposes of examination, elections, and other functions. See *Notice to Members 88-51*. District Office staff may conduct onsite cause and cycle examinations at foreign locations of a member firm.

VII. Compliance With Laws

Q 18. What laws must members comply with when soliciting business in a foreign jurisdiction?

A. Members and persons associated with members must comply with applicable U.S. and foreign laws when soliciting business in a foreign jurisdiction. See *Notices to Members 00-02* and *98-91*. Members should carefully review all foreign laws as foreign jurisdictions may have different laws and policies than the U.S. and the NASD.

Q 19. What activities may be considered a “solicitation”?

A. The term “solicitation” generally has been viewed as an expansive, fact-specific, and variable concept. Depending on the laws of the applicable foreign jurisdiction, a wide variety of firm activities may constitute solicitation of business for purposes of foreign local law. For example, solicitation of business may be deemed to occur through newspaper ads, Internet postings, e-mails, telephone calls, or facsimile transmissions. See *Notice to Members 00-02*.

Q 20. What are the consequences of breaching applicable foreign laws?

A. The consequences of breaching applicable foreign laws can be far reaching. Among other things, member firms in violation of particular

foreign laws may be committing a criminal offense and be liable to prosecution. See *Notices to Members 00-02* and *98-91*.

VIII. Qualification Requirements

Q 21. What are the qualification requirements for persons registered in a foreign jurisdiction who want to work in the United States as general securities representatives?

A. In general, the NASD requires persons registered in foreign jurisdictions to take the Series 7 examination prior to working in the U.S. as a general securities representatives. However, the NASD permits persons registered in Canada and the United Kingdom to work in the U.S. as general securities representatives after taking abbreviated versions of the Series 7 examination. Because the NASD relies, in part, on foreign regulators to ensure that representatives have attained certain minimal levels of qualification, these abbreviated examinations are meant to supplement tests that foreign representatives have already taken in their original jurisdiction.

The examination for United Kingdom representatives (Series 17) consists of 90 questions and is 120 minutes long. The examination for Canadian representatives (Series 37) consists of 90 questions and is 150 minutes long, or alternatively, if the

Canadian representative also has the Canadian options and futures program, such representative may choose to take the Series 38 examination, which contains 45 questions long and is 75 minutes long.

Q 22. Do foreign regulators offer abbreviated qualification examinations for U.S. representatives?

A. Yes. The United Kingdom and Canada currently offer abbreviated qualification examinations for U.S.-qualified registered representatives.

Q 23. Have any foreign regulators waived their examination requirements?

A. The NASD understands that some foreign regulators may waive their examination requirements for persons with significant experience. Member firms should contact foreign regulators with regard to any examination waiver programs and the application of such programs.

Q 24. Can the NASD waive examination requirements for foreign representatives?

A. *NASD Rule 1070(e)* provides that the NASD may waive the applicable qualification examination, on a case-by-case basis, in exceptional cases and where good cause is shown and accept other standards as evidence of an applicant’s qualifications for registration.

Q 25. Does the NASD offer examinations abroad?

- A. Yes. The NASD currently offers automated examinations in (1) Sydney, Australia, (2) Hong Kong, (3) Paris, France, (4) Frankfurt, Germany, (5) Tokyo, Japan, (6) Singapore, (7) Seoul, South Korea, and (8) London, England. To schedule an appointment at a foreign examination location, a member firm must submit a foreign appointment request form one month before the desired test date. Candidates may make arrangements for a paper examination in other locations. See www.nasdr.com.

All candidates taking NASD examinations overseas may request an extra hour and the use of an English/native language dictionary. However, these requests are not automatically granted and must be approved by the staff. Upon arrival at the test center, candidates must provide an originally executed letter from the firm verifying that the candidate speaks English as a second language.

IX. Continuing Education

Q 26. Are foreign representatives required to comply with continuing education requirements?

- A. In general, yes. Under *NASD Rule 1120*, foreign representatives and domestic representatives are subject to the same continuing education requirements.

The continuing education program is comprised of a Regulatory Element and a Firm Element. The Regulatory

Element is computer-based training in which participants work through real-life regulatory and compliance problems. The Firm Element is internal training administered by firms and may include written material, computer-based training, videos, audio tapes, classroom training, direct broadcasts, or other presentations.

Q 27. How can a registered person residing outside North America satisfy the regulatory element requirement?

- A. Registered persons outside North America are subject to the requirements of the Regulatory Element. A registered person subject to the Regulatory Element may satisfy his or her requirement at any Sylvan/Prometric Center in the United States and Canada, or one of the VUE Centers in Europe and the Pacific Rim. Registered persons outside the United States and Canada who are not living within 350 miles of a VUE Center may have their Regulatory Element requirement deferred until facilities are available. To obtain a deferral, a registered principal or supervisor of the firm must make the request in writing to the Continuing Education Department of NASD Regulation. The letter should contain the person's name, Social Security or CRD number, and the city and country in which the person resides. See *Notices to Members 01-50 and 01-73* for more information.
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Q 28. Are Foreign Associates required to comply with continuing education requirements?

- A. No. Foreign Associates are exempt from the Regulatory Element and the Firm Element of the continuing education requirement.
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X. Miscellaneous

Q 29. In connection with the establishment of a foreign office by a member firm, foreign regulators may ask for confirmation that the member firm is in good standing. Can the NASD opine on the good standing of a member?

- A. As a matter of policy, the NASD does not opine that a member is in "good standing" because that term may have different meanings in different jurisdictions. The NASD can confirm that a member is registered with the NASD as a broker/dealer and as such has initially satisfied and continues to meet certain mandatory qualification standards, and is subject to NASD rules and regulations requiring it to operate in a just and equitable manner.
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Q 30. How can foreign regulators be contacted?

- A. The International Organization of Securities Commissions (IOSCO), an organization of securities regulators, maintains a listing of regulators around the world. IOSCO can be contacted by e-mail at mail@oicv.iosco.org. IOSCO maintains a Web Site at www.iosco.org.

Endnotes

- 1 It is not the intent of this *Notice* to describe any specific foreign laws applicable to any foreign jurisdiction. Rather, the NASD urges members considering the conduct of business in foreign jurisdictions to carefully review and comply with all applicable U.S. and foreign laws.
- 2 Members should review the rules and regulations in all applicable jurisdictions to determine whether offices may need to be registered with other regulators, including state and foreign regulators.

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