Chapter 49E

Offering Cross-Border Investment Products and Advisory Services to Clients in Latin America

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§ 49E:1 Introduction

Over the last five years, markets in Latin America[1] have experienced tremendous economic growth. A decade long run-up in commodities prices; high demand from China for natural resources from

1. For purposes of this chapter, Latin America is defined as the territories of the Americas south of the United States where a language derived from Latin is spoken, including, but not limited to, Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Mexico, Nicaragua, Panama, Paraguay, Peru, Uruguay, and Venezuela. *See* WILLIAM R. SHEPHERD, LATIN AMERICA (H. Holt & Co. 1914) (defining the term Latin America).

countries like Brazil, Chile, Peru and Argentina; inexpensive international funding; improvement in leadership in Latin America; and increased stability in the region (among other factors) have all created a burgeoning middle class and unprecedented wealth in the region.[2] Many U.S. financial services firms have attempted to take advantage of this increased wealth among Latin American investors, including family offices, high net worth individuals and institutions, by offering cross-border brokerage and advisory services from the United States.

Global financial services firms seeking to offer brokerage and advisory services to Latin American clients on a cross-border basis face complexities that are often dictated by a maze of regulation that was originally developed long before the internationalization of global capital markets. As a result, any involvement in the marketing, management, or distribution of investment products to Latin American clients by U.S. based firms will require an evaluation of a number of legal considerations arising both under U.S. law, as well as the laws of the jurisdiction of the investor's residence or domicile.

Whether a local national regulator will assert jurisdiction over a U.S. broker-dealer or investment adviser providing brokerage and/or advisory services on a cross-border basis from the United States to a resident of (or entity domiciled in) Latin America is a facts-and-circumstances analysis. This chapter will examine the key considerations for U.S.-based financial services firms that wish to market and provide investment products on a cross-border basis to Latin American clients.

§ 49E:2 Application of U.S. Regulation

Generally, the U.S. Securities and Exchange Commission (SEC) takes the position that, once registered, a financial services firm with its principle place of business in the United States, whether an adviser or broker-dealer, must comply with the full panoply of U.S. broker-dealer and investment adviser regulations with respect to both its U.S. and non-U.S. clients.[3] As a result, U.S. based financial services firms

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2. Conrad de Aenlle, *Latin American Markets Aim for a New Decade of Gains*, N.Y. TIMES, Apr. 7, 2012.
3. *See* SEC, Division of Investment Management, Protecting Investors: A Half Century of Investment Company Regulation (1992) [hereinafter 1992 Report], at 223 (noting the position of the Commission with respect to the application of broker-dealer regulation to U.S. based broker-dealers); *see also* Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers, Investment Advisers Act Release No. 3222 (June 22, 2011) [hereinafter 2011 Exemptions Release] (noting the position of the Commission staff with respect to the application of investment adviser regulation to U.S. based investment advisers).

offering advisory services to Latin American clients must generally comply with all of the substantive provisions of the U.S. Investment Advisers Act of 1940 (the "Investment Advisers Act")[4]. In addition, firms marketing investment products and providing brokerage services to non-resident alien clients ("NRA Clients")[5] resident in Latin America should consider the full application of the U.S. federal securities laws to their activities, including the application of the substantive provisions of U.S. Securities Exchange Act of 1934, as amended (the "Exchange Act"), and the rules and regulations of the Financial Industry Regulatory Authority (FINRA).[6]

Depending on the investment product offered to the Latin America client (for example, mutual funds, private funds, advisory services, etc.), an investment firm may also need to consider (among other federal securities laws) the registration provisions of the U.S. Securities Act of 1933, as amended (the "Securities Act") and the Investment Company Act of 1940, as amended (the "Investment Company Act"). In addition, there are a number of other key considerations with respect to the application of the U.S. federal securities laws that should be considered by a U.S. firm (in addition to foreign regulation) when offering cross-border investment products and brokerage services to Latin American clients, as discussed more fully below.

§ 49E:3 Offering Mutual Funds to Latin American Clients

§ 49E:3.1 Tax Considerations

While U.S. mutual funds are sold outside of the United States to Latin American clients (including, for example, to pension funds in Chile),[7] Latin American clients often prefer offshore (that is, non-U.S.) mutual funds for tax reasons.

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4. *See* 2011 Exemption Release, *supra* note 3; *see also* Reavis & McGrath, SEC No-Action Letter (pub. avail. Oct. 29, 1986); *see also* Gim-Seong Seow, SEC No-Action Letter (pub. avail. Nov. 30, 1987).
5. Generally, individuals maintaining a brokerage relationship with U.S. broker-dealers can be divided into two categories: resident aliens and nonresident aliens (NRAs). For definitional purposes, an NRA is a non-U.S. citizen who (i) is not a lawful permanent resident of the United States during the calendar year and who does not meet the "substantial presence test;" or (ii) has not been issued an alien registration card, known as a green card. A U.S. financial institution's Customer Identification Program (CIP) will identify accounts opened for NRAs.
6. FINRA was created through the consolidation of the National Association of Securities Dealers (NASD) and the New York Stock Exchange Regulatory Body. See Exchange Act Release No. 56,145 (July 26, 2007).
7. For a complete list of U.S. mutual funds approved for sale to Chilean pension funds, see Comisión Clasificadora de Riesgo (CCR) Home Page, *available at* www.ccr.cl.

[A] U.S. Mutual Funds

Generally, U.S. registered mutual funds are required to pay distributions of all their income and realized gains each year.[8] Distributions are taxable whether an investor takes them in cash or reinvests the distribution in the fund. Distributions received from the mutual fund are treated as regular dividends; capital gain dividends; distributions of tax-exempt interest; or as a return of capital, depending upon the source from which the distributions are made.[9] Distributions treated as regular dividends are subject to a 30% U.S. withholding tax on foreign shareholders, unless the rate is reduced by a treaty between the United States and the foreign investor's country of residence. Capital gain distributions (from the mutual fund's net long-term capital gains) and exempt interest dividends are generally not subject to withholding. On the other hand, dividend distributions to foreign shareholders from U.S. mutual funds constituting short-term capital gains and other ordinary income would be subject to a 30% (or lower treaty rate) withholding tax as regular dividends.[10]

[B] Foreign Mutual Funds

By contrast, a number of financial institutions offer mutual funds, which are incorporated, managed, and sold outside of the United States ("Foreign Mutual Funds"), including European domiciled Undertaking for Collective Investment in Transferable Securities (UCITS).[11] Generally, the dividend distributions made by these offshore mutual funds generally are exempt from U.S. withholding tax. In addition, many Foreign Mutual Funds, including UCITS, are not subject to local taxation in the place of their organization on any income or gains they may realize from their investments. In addition, there are often no local withholding taxes in respect of a distribution of payments by a UCITS to Latin American shareholders up on redemption, cancellation or transfer of shares.[12] As a result, many

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8. *See* U.S. Internal Revenue Code, Subchapter M—Regulated Investment Companies and Real Estate Investment Trusts, 26 U.S.C. §§ 851–860 (2012).
9. *Id.*
10. *Id*.
11. "UCITS" (Undertaking for Collective Investment in Transferable Securities) generally refers to a European domiciled mutual fund formed or organized under the national law of a European Union member state that complies with EU Directive 2009/65, 2009 O.J. (EC) of the European Parliament and the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities. UCITS, 2001/107, 2009 O.J. (L 302) (EC).
12. *See* Ernst & Young, Technical Guide to UCITS (pub. avail. 2012).

Latin American NRA clients prefer to invest in Foreign Mutual Funds (for example, UCITS), which can present a number of U.S. regulatory challenges if sold through the United States.

§ 49E:3.2 *Application of the Exchange Act*

As a direct result of tax preferences of NRA clients, a number of U.S. financial institutions utilize the UCITS vehicle, which was originally developed to facilitate distribution within Europe, to target investors in fast growing markets in Latin America both directly as well as indirectly through the United States. Often a UCITS will facilitate the sale of its shares to investors in Latin America by "wholesaling" the product to U.S. broker-dealers and financial intermediaries that serve as "gatekeepers" to existing international selling networks or otherwise have Latin American NRA clients. While these *targeted* U.S. financial intermediaries are generally registered under the Exchange Act, a question arises as to whether the entity *targeting* these U.S. financial intermediaries should also be registered as a broker-dealer under the Exchange Act and be a member of FINRA.

[A] Direct Sales

Section 15(a)(1) of the Exchange Act makes it unlawful for any "broker" or "dealer" to make use of the mails or instrumentalities of interstate commerce to effect transactions in any *security*, or to induce or to attempt to induce the purchase or sale of any *security*, unless that broker or dealer is registered pursuant to the Exchange Act or otherwise exempt from registration.[13] While more than a dozen terms utilized in section 15(a) of the Exchange Act are defined in section 3 of the Exchange Act,[14] the SEC has adopted, in essence, a territorial approach to broker-dealer regulation that provides that entities or persons conducting activities relating to the offer, sale, or inducement to purchase or sell any *security* within the United States must register with the SEC as a broker-dealer.[15] As defined in section 3 of the

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13. Exchange Act § 15(a)(1), 15 U.S.C. § 80a(1) (2011), which states: "It shall be unlawful for any broker or dealer which is either a person other than a natural person or a natural person not associated with a broker or dealer which is a person other than a natural person (other than such a broker or dealer whose business is exclusively intrastate and who does not make use of any facility of a national securities exchange) to make use of the mails or any means or instrumentality of interstate commerce to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security (other than an exempted security or commercial paper, bankers' acceptances, or commercial bills) unless such broker or dealer is registered in accordance with subsection (b) of this section."
14. *See* DAVID A. LIPTON, 15 BROKER DEALER REGULATION § 1:2 (West 2011).
15. *See* Registration Requirements for Foreign Broker-Dealers, Exchange Act Release No. 27,017 (July 11, 1989) [hereinafter Release 27,017].

Exchange Act, the term *security* would include shares of a UCITS, as well as units/shares of other U.S. and non-U.S. investment funds.[16]

It is important to note that the SEC requires registration, not only in instances in which a foreign broker-dealer from outside of the United States induces or attempts to induce securities transactions with American citizens within the United States, but also requires registration of all broker-dealers physically operating within the United States.[17] This registration is required even if securities are directed only to (or effected for) foreign investors outside the United States (for example, Latin American clients).[18] In explaining this policy, the SEC has noted, "Although the protection of foreign investors is not the primary purpose of the U.S. securities laws, the staff believes that the SEC has a strong interest in regulating the conduct of securities professionals within the United States".[19] As a result, any financial intermediary that wishes to offer brokerage services or investment products (including UCITS) from the United States directly to Latin American clients must be registered under the Exchange Act and be a member of FINRA.

An example of the SEC's territorial approach can be seen in its recent enforcement action against Banco Espirito Santo S.A.[20] In that action, the SEC charged multi-national banking conglomerate Banco Espirito Santo S.A. (BES) with violations of the broker-dealer (as well

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16. *See* section 3(a)(10) of the Exchange Act defining the term "security" as:

> 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, pre-organization 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 exchange 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.

17. *See* Release 27,017, *supra* note 15, at 30,017.
18. *Id*. at 30,016.
19. *See* Exemption of Certain Foreign Brokers or Dealers, Exchange Act Release No. 25,801 (June 14, 1988).
20. *See* In the Matter of Banco Espirito Santo S.A., Investment Advisers Act Release 3304 (Oct. 24, 2011).

as investment adviser) registration provisions (among others) of the federal securities laws.[21] BES, a commercial bank headquartered in Portugal, maintained relationships with approximately 3,800 U.S. residents, primarily Portuguese immigrants, who held products deemed to be securities under U.S. law in their brokerage and advisory accounts with BES between 2004 and 2009, and offered these U.S. customers brokerage services and the U.S. clients investment advice.[22] By acting as a broker-dealer and investment adviser to U.S. customers and U.S. clients without registering with the SEC, the SEC noted that BES violated section 15(a) of the Exchange Act and section 203(a) of the Investment Advisers Act, as well as section 5(a) and 5(c) of the Securities Act by offering and selling securities (for example, foreign mutual fund shares) in the United States without registration and without an exemption from registration.[23]

While BES had a U.S.-based wholly-owned subsidiary that was a member of FINRA and had been registered with the SEC as a broker-dealer since at least 2004, BES failed to utilize the affiliated broker-dealer to offer various financial products to U.S. customers of BES.[24] BES representatives involved in the sales activity were not registered as representatives of a broker-dealer, were not associated with an SEC-registered broker-dealer, nor did they hold any U.S. securities licenses.[25]

The BES enforcement case emphasizes the need of global financial services firms, both within the United States and outside of the United States, to utilize broker-dealers registered under the Exchange Act when offering brokerage services to foreign clients, and shares of investment funds from the United States, even if such shares are offered exclusively to non-U.S. investors.

[B] Wholesaling

Global financial service firms should also be mindful of the registration provisions of the Exchange Act when "wholesaling" shares of a non-U.S. mutual fund (for example, a UCITS) to registered broker-dealers and other financial intermediaries in the United States that may wish to offer those funds to their NRA clients. Generally, a financial intermediary will likely be considered by the SEC to be "engaged in [a] key point in the chain of distribution of a security"[26] when wholesaling shares of a

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21. *Id*. at 2.
22. *Id*.
23. *Id.*
24. *Id.* at 3.
25. *Id*.
26. MuniAuction, Inc., SEC No-Action Letter (Mar. 13, 2000) (quoting Mass. Fin. Servs., Inc. v. Sec. Inv. Protection Corp., 411 F. Supp. 411, 415 (D. Mass. 1976)). This activity would ordinarily subject a broker-dealer to registration under the Exchange Act and require that the broker-dealer become a member of FINRA.

foreign mutual fund to U.S. financial intermediaries. Consequently, such a financial intermediary will generally be considered to be engaging in brokerage activity subject to regulation under the Exchange Act.[27] FINRA staff also views wholesaling as a "quintessential sales activity" in connection with distribution of certain investments.[28] As a result, financial intermediaries should be mindful of not only the registrations provisions of the Exchange Act, but also of the substantive client relationship rules of FINRA in connection with "wholesaling" investment funds that will ultimately be sold to Latin American clients.

§ 49E:3.3 Application of FINRA Licensing Provisions

Generally, NASD Rule 1031 requires associated persons of a member to register as representatives if they are engaged in the investment banking or securities business for the member. In addition to traditional investment banking and securities business, Rule 1031 also applies to the sales activities of FINRA member firms that attempt to facilitate the sale of foreign mutual fund shares to retail customers outside of the United States through distribution arrangements with U.S. registered broker-dealers in the United States that have existing international selling networks outside of the United States.

In an interpretive letter issued to PIMCO Funds Distributors,[29] FINRA (then the NASD) indicated that where representatives of a broker-dealer are regularly involved in written or oral business communications with customers with respect to the sale of non-U.S. mutual fund shares, either alone or accompanied by registered

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27. *Id*.
28. National Association of Securities Dealers, Inc.; Regulation of Compensation, Fees, and Expenses in Public Offerings of Real Estate Investments Trusts and Direct Participation Programs, Exchange Act Release No. 54,118 (July 10, 2006).
29. Application of Registration and Supervisory Requirements to Certain Activities Conducted by a Member Firm in the U.S. Relating to Sales Outside the U.S. of Foreign Mutual Funds, NASD Interpretive Letter (June 6, 2001) (the "PIMCO Letter"). At the time of the PIMCO Letter, PIMCO had created in Ireland investment companies that were not registered under the Investment Company Act and were organized as UCITS. PIMCO proposed to offer shares of its Irish UCITS to retail customers outside the U.S. through its U.S. based distributor, PIMCO Funds Distributors LLC (PFD). PFD would act as principal distributor of the UCITS and would establish an international wholesaling group in the U.S. for UCITS shares. PFD would facilitate the sale of shares of the UCITS to retail customers outside of the U.S. through distribution arrangements with registered broker-dealers in the U.S. that had existing international selling networks. PFD proposed not to sell shares of the UCITS directly to U.S. retail customers.

sales personnel, these representatives would be required to be registered with FINRA, as their conduct would be part of the general sales effort of the firm.[30] Further, FINRA has stated that unregistered persons of a FINRA member firm may not discuss general or specific investment products or services offered by the firm, pre-qualify prospective customers as to financial status and investment history and objectives, or solicit new accounts or orders with respect to its foreign mutual funds.[31]

It is important to note that NASD Rule 1060(a), however, exempts from registration associated persons who, among other things, function *solely and exclusively in a ministerial or clerical capacity*. In the PIMCO Letter, the staff described ministerial and clerical activities to include the shipment of sales literature relating to offshore funds to broker-dealers and account executives that had requested those documents, and providing current performance data and information on administrative matters to account executives at such U.S. broker-dealers.[32]

To the extent that the activities of a broker-dealer's employees with respect to a foreign mutual fund would require registration as a representative with FINRA, such employees would be required to obtain a Series 7 (General Securities Representative) License. Further, all supervisors of Series 7 registered representatives must maintain a Series 24 (General Securities Principal) License.[33] Thus, a supervisor of registered representatives conducting wholesaling activities on behalf of a foreign mutual fund will be required to hold both Series 7 and Series 24 Licenses.

While some lines can be drawn by a broker-dealer on what activities in the "wholesaling" context may be performed without appropriate licensing, any U.S. representative of a broker-dealer that communicates with U.S. intermediaries about a foreign mutual fund (whether in person or by telephone) should be appropriately licensed.

§ 49E:3.4 Applicability of FINRA Sales Literature Rules

All broker-dealers are generally subject to FINRA's Conduct Rules governing the content of sales material and advertisements.[34] As such, such intermediaries should consider the content standards of FINRA

30. *Id.*
31. *Id.*
32. *Id.*
33. Supervisor of registered representatives conducting wholesaling activities on behalf of a foreign mutual fund will be required to hold series 7 and series 24.
34. NASD Rule 2210 generally provides content standards that must be followed when members make communications to the public. Communications are deemed to include advertisements, sales literature,

rules with respect to any foreign fund marketing material, even if such marketing material is used exclusively with Latin American clients or U.S. financial intermediaries.[35]

[A] Institutional Sales Material

NASD Rule 2211 provides an exception from the requirements of Rule 2210 for communications made to "institutional investors."[36] Sales material delivered to institutional investors are not required to be filed with FINRA, and are only required to comply with the general FINRA guidelines governing advertising as set forth in Rule 2210(d)(1).[37] To the extent that U.S. intermediaries are deemed to be "institutional

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correspondence, and public appearances, among other things. *See* NASD Rule 2210. As part of its continuing effort to create a consolidated rulebook, FINRA has proposed a new FINRA Rule 2210 that has been adopted by the SEC and that would subsume, subject to certain changes, the provisions of current NASD Rules 2210 and 2211, NASD Interpretive Materials 2210-1 and 2210-4, and the provisions of Incorporated NYSE Rule 472 that do not pertain to research analysts and research reports. *See* FINRA Regulatory Notice 12-29 (pub. avail. Feb. 4, 2013). FINRA Rule 2210 will continue to retain the old content standards, but rather than addressing them in a series of Interpretive Memos that follow the rule, they will be codified in the rule itself and in several subsequent rules.

35. FINRA has stated that "sales material published or distributed by a [FINRA] member is subject to Rule 2210, even if a non-member such as a hedge fund manager prepared it." Further Interpretive Advice to Members Concerning the Sale of Hedge Funds, NASD Interpretive Letter (Oct. 2, 2003) (the "SIA Letter").

36. Institutional investors are defined to include: (i) banks, savings and loan associations, insurance companies, and registered investment companies; (ii) investment advisers registered either with the SEC or with a state securities commission; (iii) entities with total assets of at least $50 million; (iv) government entities or subdivisions; (v) certain employee benefit plans; (vi) qualified plans as defined in the Exchange Act; (vii) FINRA members or registered associated persons; and (viii) persons acting on behalf of any institutional investor.

37. Rule 2210(d)(1) generally provides that: (i) all member communications with the public must be based on principles of fair dealing and good faith, must be fair and balanced, and must provide a sound basis for evaluating the facts in regard to any particular security or type of security, industry, or service; (ii) no member may make any false, exaggerated, unwarranted, or misleading statement or claim in any communication with the public; (iii) information may be placed in a legend or footnote only in the event that such placement would not inhibit an investor's understanding of the communication; (iv) communications with the public may not predict or project performance, imply that past performance will recur, or make any exaggerated or unwarranted claim, opinion, or forecast; and (v) if any testimonial in a communication with the public concerns a technical aspect of investing, the person making the testimonial must have the knowledge and experience to form a valid opinion.

investors,"[38] wholesaling broker-dealers should not be prohibited from forwarding the sales material to other U.S. intermediaries under FINRA rules, provided that (i) the sales material satisfies the general requirements of Rule 2210(d)(1); and (ii) the broker-dealer does not have a reason to believe that the sales material will be forwarded or made available to any U.S. person other than an institutional investor.[39]

[B] Interpretive Guidance

FINRA has previously issued an interpretive letter (the "Credit Suisse Letter") permitting a member broker-dealer to provide investors with marketing materials relating to private funds, which are exempt from registration under the Investment Company Act, that did not fully comply with NASD Rule 2210.[40] The Credit Suisse Letter generally permitted Credit Suisse First Boston (CSFB) to send prospective investors related performance information in connection with the promotion of a private equity fund. According to CSFB, these funds were made available to investors that met the definition of "qualified purchaser" under section 2(a)(51) of the Investment Company Act.[41] In permitting this activity, FINRA recognized that:

> the presentation of related performance information with respect to an unregistered private fund that is excluded from the definition of "investment company" under Section 3(c)(7) of the Investment Company Act does not present the same investor protection concerns as the presentation of related performance information with respect to mutual fund shares.[42]

In its response to CSFB, FINRA stated that it would not object if a member broker-dealer included related performance information in

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38. As discussed *supra* note 36, only U.S. Intermediaries, as members of the FINRA, would be considered institutional investors. NASD Rule 2211(a)(3)(E).
39. NASD Rule 2211(a).
40. Guidance Regarding the Use of Related Performance Information in Sales Material for Private Equity Funds, NASD Interpretive Letter (Dec. 30, 2003) [hereinafter Credit Suisse Letter].
41. Section 2(a)(51) defines a "qualified purchaser" to include (i) any natural person who owns $5 million or more in investments; (ii) any company that owns more than $5 million in investments and that is owned directly or indirectly by or for two or more natural persons who are related as siblings or spouse; (iii) any trust that is not covered in (ii) and that was not formed specifically for the purpose of acquiring the securities offered; and (iv) any person, acting for its own account or the accounts of other qualified purchasers, who in the aggregate owns and invests on a discretionary basis $25 million or more in investments. 15 U.S.C. § 80a-2(a)(51) (2011).
42. Credit Suisse Letter, *supra* note 40.

sales material for a private fund relying on the exemption from registration under section 3(c)(7) of the 1940 Act (a "3(c)(7) Fund") if it ensured that the recipients of all such materials were "qualified purchasers."[43] In stating its position, FINRA noted that the sales material would remain subject to the remaining applicable standards of Rule 2210 and the relevant interpretive materials thereunder.

FINRA's position in the Credit Suisse Letter is helpful in analyzing whether the full range of FINRA advertising regulations apply to sales material for Foreign Mutual Funds (which are private funds for U.S. purposes) that are ultimately directed at non-U.S. persons outside of the United States.

§ 49E:3.5 Application of the Securities Act

Section 5 of the Securities Act makes it illegal to offer or sell unregistered securities through any means of U.S. interstate or international commerce through the United States unless the security or the transaction is exempt from registration with the SEC.[44] Shares of a Foreign Mutual Fund are generally regarded as a security for purposes of the Securities Act. As such, the shares must be (1) registered with the SEC, (2) exempt from registration, or (3) sold in an exempt transaction.

U.S. mutual funds that are sold to Latin American investors directly are already registered under section 5 of the Securities Act. Foreign Mutual Funds (notably UCITS), however, typically have relied upon Regulation S, section 4(2), and Regulation D of the Securities Act for transactions in their shares in order to avoid the registration provisions under the Securities Act when offering shares through U.S. registered broker-dealers that have NRA clients or international selling networks that can offer the shares to non-U.S. high net worth or institutional clients in Latin America. For purposes of this chapter, we will only focus on sale of shares of a Foreign Mutual Fund to non-resident Latin American clients under Regulation S, and not under section 4(2) or Regulation D, which are also available exemptions from registration.

[A] Scope of Regulation S[45]

While the SEC interprets the scope of section 5 of the Securities Act very broadly,[46] it historically has taken the position that the registration requirements of the Securities Act do not apply to offers and sales

43. *Id.*
44. 15 U.S.C. § 77e (2011).
45. 17 C.F.R. §§ 230.901–.904 (2012).
46. *See* Offshore Offers and Sales, Securities Act Release No. 6863, 55 Fed. Reg. 18,306 (May 2, 1990) [hereinafter Regulation S Adopting Release].

of securities made abroad when the offers and sales are made with only *incidental* U.S. contacts, and are made in such a way as reasonably to preclude redistribution of the securities in the United States.[47]

Regulation S represents an attempt by the SEC to clarify the extraterritorial application of the Securities Act's registration requirements.[48] In Regulation S, the SEC embraced a territorial approach to the application of registration under the Securities Act.[49] Regulation S comprises four rules: Rules 901, 902, 903, and 904.[50] Rule 901 states that only *offers* and *sales* of securities inside the United States are subject to section 5.[51] As such, the primary inquiry in the context of a Foreign Mutual Fund (for example, a UCITS) offering to Latin American clients through a U.S. broker-dealer is whether the activity of the fund, its global distributor, and/or any contracted dealer *rises to the level of an offer*, and, if so, whether the "offer" and "sale" of securities occurs "outside of the United States."[52]

Section 901 of Regulation S states that, for the purposes only of section 5 of the Securities Act, the terms "offer," "offer to sell," "sell," "sale," and "offer to buy" shall be deemed not to include offers and sales that occur outside the United States.[53] To clarify, when offers and sales of securities are deemed to occur outside the United States for purposes of the Securities Act, Regulation S provides two non-exclusive "safe harbor" provisions in Rules 903 (issuer safe harbor) and 904 (safe harbor for resales).[54] If the offer and sale satisfy the conditions of either of the safe harbor provisions, such transaction will be deemed to have occurred outside of the United States, and outside the reach of section 5.[55] Since the primary issue for Foreign Mutual Funds offering through U.S. intermediaries is generally the initial sale of shares, the below discussion focuses on the issuer safe harbor.

The issuer safe harbor is applicable to not only the actual issuer (for example, the UCITS), but also to the issuer's distributors (for example, the broker-dealer), their respective affiliates, and persons acting on behalf of such entities.[56] The safe harbor may be utilized by foreign

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47. However, any foreign public offering specifically directed at an identifiable group of U.S. nationals resident abroad (*e.g.*, U.S. armed forces personnel stationed abroad) would not be covered under this interpretation. *See* 17 C.F.R. § 230.902(h)(2) (2012).
48. *See* Regulation S Adopting Release, *supra* note 46.
49. *Id.*
50. 17 C.F.R §§ 230.901–.904 (2012).
51. 17 C.F.R. § 230.901 (2012).
52. *Id.*
53. 17 C.F.R. § 230.901 (2012).
54. 17 C.F.R. §§ 230.903–.904 (2012)
55. *Id.*
56. *See* Regulation S Adopting Release, *supra* note 46, at 18,307.

issuers offering securities outside the United States. The conditions to be satisfied to meet the issuer safe harbor depend on the type of securities being offered. The SEC separates this analysis into Categories I, II, and III.[57]

Category I securities are securities of "foreign issuers" for which there is no "substantial U.S. market interest,"[58] securities offered and sold in "overseas directed offerings," securities that are backed by the full faith and credit of a foreign government, and securities sold pursuant to certain employee benefit plans.[59] Offerings falling within Category II are those by foreign and U.S. companies that are subject to reporting under the Exchange Act.[60] The final safe harbor category, Category III, applies to all securities not in Categories I or II.[61]

In many situations, a Foreign Mutual Fund will be considered, for the purposes of Regulation S, a "foreign private issuer,"[62] when there is no "substantial U.S. market interest" in the shares. Accordingly, a

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57. Under the Regulation S regulatory scheme, Category I securities are subject to the least regulatory restrictions and Category III are subject to the most restrictive. The categorization of securities is based upon the likelihood that the securities will flow back to the U.S. As the probability that the securities will flow back to the U.S. increases, the procedural requirements to avoid registration become more difficult. *Id.*
58. Whether a "substantial U.S. market interest" exists depends on the type of securities being offered. Generally, if a foreign issuer is offering equity securities such as Shares, a substantial U.S. market interest is deemed to exist at the commencement of the offering if (i) U.S. securities exchanges and inter-dealer quotation systems in the aggregate constituted the single largest market for the class of securities in the shorter of the issuer's prior fiscal year or the period since the issuer's incorporation; or (ii) 20 percent or more of all trading in such class of securities took place in, on or through the facilities of securities exchanges and inter-dealer quotation systems in the U.S. and less than 55 percent of such trading took place in, on or through the facilities of securities markets of a single foreign country in the shorter of the issuer's prior fiscal year or the period since the issuer's incorporation. A substantial U.S. market interest would not exist for the Company under this test. 17 C.F.R. § 230.902(n) (2012).
59. Regulation S Adopting Release, *supra* note 46, at 18,313.
60. *Id.* at 18315.
61. *Id.* at 18318.
62. The term "foreign private issuer" is defined in Rule 405 of the Securities Act and Rule 3b-4 of the Exchange Act. Generally, the term foreign private issuer means any "foreign issuer" other than a foreign government, except an issuer meeting the following conditions as of the last business day of its most recently completed second fiscal quarter: (i) more than 50% of the issuer's outstanding voting securities are directly or indirectly owned of record by residents of the U.S.; and (ii) any of the following: (a) the majority of the executive officers or directors are U.S. citizens or residents.; (b) more than 50% of the assets of the issuer are located in the U.S.; or (c) the business of the issuer is administered principally in the U.S. 17 C.F.R. § 230.405 (2012); 17 C.F.R. § 240.3b-4 (2012).

UCITS is often considered a Category I issuer under the analysis of Regulation S. In order for sales by a Category I issuer (or any person acting on behalf of such issuer) to qualify for the issuer safe-harbor under Regulation S, there must be no "directed" selling efforts and the sale must occur in an "offshore transaction."

[A][1] "Offshore Transactions"

For purposes of Regulation S, an "offshore transaction" includes, among other transactions, a transaction in which no offer is made to a person in the United States and, at the time that the buy order is originated, the buyer is outside of the United States, or the seller *reasonably believes* that the buyer is outside of the United States .The SEC has stated that an offer to persons in the United States includes offers made to "transient visitors" who are not U.S. residents.[63] Thus, U.S. broker-dealers engaged by the UCITS are not permitted under Regulation S to *offer* or *sell* shares to any person (even a person who is not a U.S. resident) while that person is physically present in the United States.[64]

[A][2] "Directed Selling Efforts"

"Directed selling efforts" include any activity undertaken for the purpose of, or that could be reasonably expected to have the effect of, conditioning the market in the United States for the security being offered in reliance on Regulation S.[65] Directed selling efforts include marketing efforts, such as the mailing of printed material to U.S. persons;[66] the use of promotional seminars; or the placement of an

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63. *See* Regulation S Adopting Release, *supra* note 46, at 18,307, 18,316.
64. Because the determination of whether an offshore transaction has taken place turns on where and how an *offer* and *sale* are made, if an investor were to move to the United States after subscribing for shares of a Foreign Mutual Fund in accordance with Regulation S, the Foreign Mutual Fund could continue to rely on the Regulation S safe harbor provided that the initial offer and sale to such investor were, and any subsequent offer and sale of Shares are, made in accordance with Regulation S.
65. 17 C.F.R. § 230.902 (2012).
66. For purposes of Regulation S, a "U.S. person" generally includes any natural person resident in the United States; any partnership or corporation organized or incorporated under the laws of the United States; any trust or estate of which any trustee, executor, or administrator is a U.S. person; any agency or branch of a non-U.S. entity located in the United States; any non-discretionary account or similar account (other than an estate or trust) held by a dealer or other fiduciary for the benefit or account of a U.S. person; any discretionary account or similar account (other than an estate or trust) held by a dealer or other fiduciary organized, incorporated, or (if an individual) resident in the United States; and any

advertisement in publications with general circulation in the United States. It is important to note that sales material should not be posted on a website that is accessible by U.S. investors.

As an exception to these general requirements, the Regulation S safe harbor also is available when the offer or sale is made in the United States to a discretionary account (other than an estate or trust) held by a U.S. professional fiduciary for the benefit of a non-U.S. person.[67] Such offers and sales of securities are deemed to be "offshore transactions," and contacts with such fiduciaries are permitted under Regulation S.[68]

It is important to note that the SEC staff has confirmed that an issuer will not be subject to registration under the Securities Act or any liability resulting therefrom if the issuer has no direct knowledge of the sale of shares to a U.S. Person (for example, as a client of a dealer).[69] Further, the SEC staff has indicated that, in the context of a global private offering, an offshore fund may rely simultaneously on both Regulation S and section 4(2) of the Securities Act (and Regulation D thereunder) in avoiding registration under both the Investment Company Act and the Securities Act.[70]

The SEC staff also has stated that an offshore fund may use U.S. jurisdictional means to effect its private offering activities, including through the performance of any "Ten Commandments" administrative functions,[71] as long as those activities that amount to an offer or

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partnership or corporation organized or incorporated under the laws of any foreign jurisdiction formed by a U.S. person for the purpose of investing in unregistered securities unless owned by accredited investors who are not natural persons. *See* 17 C.F.R. § 230.902(k) (2012).

67. *See* 17 C.F.R § 230.902(h)(1)(ii)(B)(3) (2012); 17 C.F.R. § 230.902(k)(2)(i) (2012).

68. 17 C.F.R. § 230.902(c)(3)(ii) (2012); 17 C.F.R. § 230.902(h)(3) (2012); 17 C.F.R. § 230.902(k)(2)(i) (2012).

69. Investment Funds Institute of Canada, SEC No-Action Letter (Mar. 4, 1996).

70. Wilmer, Cutler & Pickering, SEC No-Action Letter (Oct. 5, 1998) [hereinafter Wilmer Letter].

71. *See* Treas. Reg. § 1.864-2(c)(2)(iii) (2012). The Ten Commandments activities were as follows: (1) communicating with the fund's shareholders (including the furnishing of financial reports); (2) communicating with the general public; (3) soliciting sales of the fund's stock; (4) accepting subscriptions of new shareholders; (5) maintaining the fund's principal corporate records and books of account; (6) auditing the fund's books of account; (7) distributing payments of dividends, legal fees, accounting fees, and officers' and directors' salaries; (8) publishing or furnishing the offering and redemption price of the stock issued by the fund; (9) conducting meetings of the fund's stockholders and board of directors; and (10) making redemptions of the fund's stock (collectively, the "Ten Commandment activities").

sale of securities are consistent with the regulatory restrictions on non-public offerings under section 4(2) or Regulation S.[72]

[B] Regulation S Compliance Considerations

With respect to direct sales by broker-dealers to prospective investors, including NRA Clients, a Foreign Mutual Fund will generally require a U.S. broker-dealer to enter into a sub-distribution or dealer agreement in which the U.S. based dealer will represent and warrant that it has procedures in place to comply with Regulation S. Specifically, a selling dealer is typically required to represent the following under the terms and conditions of its dealer agreement with the Foreign Mutual Fund or its distributor:

> The dealer understands the shares have not been and will not be registered under the Securities Act, and may not be offered or sold within the United States or its territories or possessions or to U.S. Persons (as such term is used in Regulation S promulgated under the Securities Act). Neither the dealer, nor any person acting on its behalf, will offer the shares, solicit an offer to buy the shares, otherwise negotiate in respect of the sale of the shares, or take any action, as a result of which the offer and sale of the shares may be required to be registered under the Securities Act or the [fund] may be required to register under the Investment Company Act. The dealer will offer and sell the shares only in offshore transactions and without directed selling efforts in the United States (as such terms are used in Regulation S promulgated under the Securities Act).

In addition, the selling dealer is often required to represent, warrant, and agree with the Foreign Mutual Fund and/or its distributor that each time a purchase of shares is placed (or otherwise cleared and settled through the National Securities Clearing Corporation's clearance and settlement system) for an account of an investor that: (i) such investor is not a U.S. Person (as defined in Regulation S); and (ii) the investor will be acquiring shares for investment purposes and not for resale.

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72. *See* Regulation S Adopting Release, *supra* note 46. The Commission staff indicated that the performance of those Ten Commandment activities that could be part of the offer or sale of securities (*e.g.*, soliciting sales of fund shares) in the United States will only implicate section 7(d) of the Investment Adviser Act if such activities result in the foreign fund making a public offering of its securities in the United States or to U.S. persons. As such, it can be argued that such activities may be undertaken within the guidelines of section 4(2) and the safe harbor provided under section 4(2), Regulation D.

§ 49E:3.6 Application of the Investment Company Act

The proposed distribution activities of a U.S. broker-dealer with respect to the sale of shares of Foreign Mutual Funds to Latin American clients through the United States also could implicate the registration provisions of the Investment Company Act, which regulates the registration of the fund itself (as opposed to its shares). Section 7(d) of the Investment Company Act prohibits any investment company organized outside the United States from using the U.S. mails or U.S. interstate commerce in connection with a "public offering" of its securities, except pursuant to an SEC order.[73] As a practical matter, section 7(d) of the Investment Company Act effectively prohibits the registration of foreign investment companies in the United States.

Because section 7(d) of the Investment Company Act by its terms applies only to public offerings, a non-U.S. investment company may avoid section 7(d) registration requirements (and registration of its securities under the laws of most states) by making a non-public offering of its securities in the United States.

In this regard, the SEC staff has noted that a non-U.S. issuer may avoid the section 7(d) registration requirements by incorporating the requirements of registration exemptions provided by section 3(c)(1) and section 3(c)(7) of the Investment Company Act into section 7(d). It is important to note section 7(d) of the Investment Company Act is only implicated if the activities of a foreign fund rise to the level of making a public offering of its securities in the United States or to U.S. Persons.

In a no-action letter issued to G.T. Global Financial Services, the SEC staff provided no-action relief under section 7(d) permitting offshore funds (for example, the UCITS) to be offered and sold in the United States by U.S. intermediaries, provided such sales are (among other restrictions) sold to non-resident, non-U.S. customers of U.S. financial intermediaries, including Latin American clients.[74]

§ 49E:3.7 Compliance with Local Law

The distribution activities of U.S. broker-dealers offering shares of mutual funds to Latin American clients also could implicate the laws of any country or territory in which an investor or prospective investor in a fund is resident or domiciled, and any country or territory of which an investor or prospective investor in a mutual fund is a citizen or national.

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73. 15 U.S.C. § 80a-7(d) (2011).
74. *See* G.T. Global Financial Services, SEC No-Action Letter (Aug. 2, 1988).

It is very common for a mutual fund to delegate compliance with local requirements to the financial intermediary offering the shares to its customers, including ensuring that the activities of the financial intermediary do not otherwise subject the shares of the mutual fund or the mutual fund itself to registration in the local jurisdiction.

In addition, the financial intermediary itself must be aware of the extent to which its own activities, including offering brokerage services or marketing investment products, give rise to local broker-dealer type licensing in the foreign jurisdiction in which its activities take place.

§ 49E:3.8 Other Material Considerations

U.S. broker-dealers should consider a number of other material considerations when dealing with Latin American clients, including (i) compliance with the general "antifraud" provisions of the federal securities laws; (ii) compliance with the conduct of business rules imposed on U.S. broker-dealers by the SEC and FINRA; (iii) global anti-money laundering (AML) legislation; and (iv) global data protection laws.

[A] Anti-Fraud Provisions

In offering shares of mutual funds (or other securities) to Latin American clients, U.S. broker-dealers must always be mindful of the "antifraud" provisions of the Exchange Act, which prohibit misstatements or misleading omissions of material facts, and fraudulent or manipulative acts and practices in connection with the purchase or sale of securities.[75] While these provisions are very broad, the SEC has adopted rules, issued interpretations, and brought enforcement actions that define some of the activities the SEC considers manipulative, deceptive, fraudulent, or otherwise unlawful.[76]

[B] Duty of Fair Dealing

Deriving from the Exchange Act anti-fraud provisions noted above, broker-dealers owe their customers a duty of fair dealing. Under the so-called "shingle" theory, a broker-dealer represents to its customers

75. Section 9(a) prohibits particular manipulative practices regarding securities registered on a national securities exchange. Section 10(b) is a broad "catch-all" provision that prohibits the use of "any manipulative or deceptive device or contrivance" in connection with the purchase or sale of any security. Section 15(c)(1) prohibits broker-dealers from effecting transactions in, or inducing the purchase or sale of, any security by means of "any manipulative, deceptive or other fraudulent device."

76. *See* Rules 10b-1 through 10b-18, 15c1-1 through 15c1-9, 15c2-1 through 15c2-11, and Regulation M of the Exchange Act.

(including its non-U.S. customers) that it will deal fairly with them, consistent with the standards of the profession. Based on this important representation, the SEC, U.S. courts, and FINRA have set forth over time certain duties for broker-dealers, including the duty to disclose certain material information and fully disclose any conflict of interest.

[C] Suitability Requirements

FINRA's suitability rule, NASD Rule 2310, applies equally to U.S. and non-U.S. customers of a broker-dealer. Under that rule and the anti-fraud provisions of the Exchange Act, broker-dealers generally have an obligation to recommend only those specific investments or overall investment strategies that are suitable for their customers. Under suitability requirements, a broker-dealer must have an "adequate and reasonable basis" for any recommendation that it makes. Reasonable basis suitability, or the reasonable basis test, relates to the particular security or strategy recommended. Therefore, the broker-dealer has an obligation to investigate and obtain adequate information about the security it is recommending.

A broker-dealer also has an obligation to determine customer-specific suitability. In particular, a broker-dealer must make recommendations based on a customer's financial situation, needs, and other security holdings. This requirement has been construed to impose a duty of inquiry on broker-dealers to obtain relevant information from customers relating to their financial situations and to keep such information current.

[D] Anti-Money Laundering Considerations

U.S. broker-dealers have robust AML obligations with respect to their activities with all clients under the U.S. Bank Secrecy Act, as amended, the USA PATRIOT Act,[77] as amended, and other relevant laws or AML obligations imposed by the Department of the Treasury's Office of Foreign Assets Control (OFAC). The substantive provisions of U.S. AML regulations apply equally to U.S. and non-U.S. clients of a U.S. broker-dealer, including Latin American clients.

U.S. broker-dealers offering shares of Foreign Mutual Funds to Latin American clients should also be aware of additional AML compliance obligations that may be imposed as a result of the type of product being sold (for example, a Luxembourg UCITS) or through contract with the Foreign Mutual Fund and/or its global distributor, as discussed more fully herein.

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77. USA PATRIOT Act, Pub. L. No. 107-56, 115 Stat. 272 (2001).

[E] Data Protection/Regulation S-P

Broker-dealers, including foreign broker-dealers registered with the SEC, must comply with Regulation S-P even if their consumers are non-U.S. persons.[78] Regulation S-P generally requires a broker-dealer to provide its customers with initial, annual, and revised notices containing specified information about the broker-dealer's privacy policies and practices.[79]

§ 49E:4 Offering Advisory Services to Latin American Clients

In addition to offering mutual funds to Latin American investors and NRA clients, a number of financial institutions offer advisory services either directly in the form of managed or separate accounts or through wrap fee programs. The offering of advisory services on a cross-border basis to Latin American clients presents a whole different set of legal issues than those created by offering mutual funds or brokerage services, a summary of which are provided below.

§ 49E:4.1 Application of the Investment Advisers Act

Section 203(a) of the Investment Advisers Act generally provides that it is unlawful for an investment adviser to engage in the business of advising *others* without registering under the Investment Advisers Act, unless an exemption is available.[80] Section 202(a)(11) of the Investment Advisers Act defines the term "investment adviser" to mean:

> "any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities."[81]

It is important to note the broadness of the definition both within and outside of the United States.[82] In addition, the Investment

78. Privacy of Consumer Financial Information (Regulation S-P), Exchange Act Release 42,974, Investment Company Act Release 24,543, Investment Advisers Act Release 1883, 65 Fed. Reg. 40,334 (June 29, 2000).
79. *Id.*
80. *See* 15 U.S.C. § 80b-3 (2011).
81. *See* 15 U.S.C. § 80b-2(a)(11) (2011).
82. *See* JANE A. KANTER & STEVE S. DRACHMAN, REGULATION OF INVESTMENT ADVISERS, REGULATION FOR ASSET MANAGERS OUTSIDE THE UNITED STATES 2 (Sweet & Maxwell ed. 2008) (discussing the breadth of the definition of investment adviser).

Advisers Act has broad application not only to the relationship between an adviser and its U.S. clients, but to the relationship with its non-U.S. clients as well, including Latin American clients.[83]

Historically, the SEC took the position that, once registered, domestic *or* foreign advisers were generally subject to all of the substantive provisions of the Investment Advisers Act with respect to both their U.S. and non-U.S. clients.[84] While this position, which poses a number of practical difficulties, is no longer the view held by the SEC with respect to foreign advisers, it is still the SEC position with respect to domestic advisers.[85]

Unlike investment advisers that are *not* domiciled in the United States,[86] a registered investment adviser with its principle place of business in the United States must comply with the substantive provisions of the Investment Advisers Act with respect to all clients, including its non-U.S. Latin American clients.[87] A "place of business" is generally defined as: (i) the office at which the adviser

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83. The Investment Advisers Act is silent regarding whether the term "others" refers only to U.S. clients. The SEC takes the position that a U.S. entity providing advice exclusively to non-U.S. persons would be subject to the Investment Advisers Act. *See* Applicability of the Investment Advisers Act to Financial Planners, Pension Consultants, and Other Persons Who Provide Investment Advisory Services as a Component of Other Financial Services, Investment Advisers Act Release No. 1092, 52 Fed. Reg. 38,400 (Oct. 16, 1987) ("Release 1092").
84. *See* 1992 Report, *supra* note 3, at 223 (noting that a domestic advisers and foreign advisers are treated differently in many respects under the Investment Advisers Act, including in both the registration context as well as the application of the substantive provisions of the Investment Advisers Act with respect to the relationship between the adviser and its clients).
85. *See* 2011 Exemptions Release, *supra* note 3; *see also* JOHN O'HANLON, REGULATION OF INVESTMENT ADVISERS: COMPLIANCE REQUIREMENTS, REGULATION FOR ASSET MANAGERS OUTSIDE THE UNITED STATES, at 29, 30 (Sweet & Maxwell ed. 2008) [hereinafter O'Hanlon]; *see also infra* note 86.
86. *See* American Bar Association, SEC Interpretive Letter (pub. avail. Jan. 18, 2012) (noting that most of the substantive provisions of the Investment Advisers Act are not applied to the non-U.S. clients of a non-U.S. adviser registered with the SEC, but non-U.S. advisers registered with the SEC must comply with the Investment Advisers Act and the SEC's rules thereunder with respect to any U.S. clients (and any prospective U.S. clients) that they may have) [hereinafter 2011 ABA Letter].
87. *See* 2011 Exemptions Release, *supra* note 3; *see also* 2011 ABA Letter, *supra* note 86; *see also* O'Hanlon, *supra* note 85; Reavis & McGrath, SEC No-Action Letter (pub. avail. Oct. 29, 1986); *see also* Gim-Seong Seow, SEC No-Action Letter (pub. avail. Nov. 30, 1987); *see also* 1992 Report, *supra* note 3, at 224 (noting that this position was similar to the position the SEC has taken with regard to broker-dealers registered under the Securities Exchange Act of 1934—*i.e.*, once a broker-dealer is registered, it is subject to the full panoply of U.S. broker-dealer regulations).

regularly provides investment advisory services or communicates with its clients; and (ii) any other location that is *held out* to the general public as a location at which the adviser provides investment advisory services or communicates with clients.[88] The concept of "holding out" is a concept of voluntary action based on a number of factors.[89] Generally, the SEC staff views an entity as holding itself out as an adviser if, among other things: (i) it advertises itself as an investment adviser or financial planner; (ii) it uses letterhead indicating activity as an investment adviser; (iii) it maintains a telephone listing or otherwise makes it known that the entity will accept new advisory clients; or (iv) it hires a person to solicit clients on its behalf.[90]

As a result, U.S. registered advisers that market and provide services to non-U.S. clients resident in Latin America must be aware of the jurisdictional reach of the Investment Advisers Act, including with respect to many of the Investment Advisers Act's client relationship rules discussed below.

§ 49E:4.2 Investment Advisers Act Client Relationship Rules

Unlike the laws of many non-U.S. jurisdictions, the Investment Advisers Act does not require minimum requisite experience for investment advisers.[91] U.S. registered investment advisers do owe, however, a fiduciary duty to all of their clients (including their non-U.S. clients), and are required to comply with certain substantive client relation rules, as well as the general anti-fraud rules of the Investment Advisers Act.

[A] General Anti-Fraud Considerations

Section 206 of the Investment Advisers Act is a general "anti-fraud" provision under which numerous activities of investment advisers are regulated.[92] Section 206 provides that it shall be unlawful for any

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88. *See* Rule 222-1(a) under the Investment Advisers Act; *see also* 2011 Exemptions Release, *supra* note 3.
89. *See* 2011 Exemptions Release, *supra* note 3; *see also, e.g.*, Brighton Pacific Realty Asst Mgmt. Co., SEC No-Action Letter (Feb. 10, 1992); Weiss, Barton Asset. Mgmt., SEC No-Action Letter (Mar. 12, 1981); Frank T. Hines, SEC No-Action Letter (Nov. 19, 1972).
90. *See* SEC Staff Bulletin No. 11, Applicability of the Investment Advisers Act to Financial Advisers of Municipal Securities Issuers (Sept. 19. 2000); *see also, e.g.*, William Bloor, SEC No-Action Letter (Feb. 15, 1980); Richard J. Shaker, SEC No-Action Letter (Aug. 1, 1977); Al O'Brien SEC No-Action Letter (Oct. 6., 1973).
91. *See* Amendments to Form ADV, Investment Advisers Act Release No. 2711 (Mar. 3, 2008).
92. *See* 15 U.S.C. § 80b-6 (2011).

investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly:

(1) to employ any device, scheme, or artifice to defraud any client or prospective client;

(2) to engage in any transaction, practice, or course of business that operates as a fraud or deceit upon any client or prospective client;

(3) acting as principal for his own account, knowingly to sell any security to or purchase any security from a client, or acting as broker for a person other than such client, knowingly to effect any sale or purchase of any security for the account of such client, without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction. The prohibitions of this paragraph (3) shall not apply to any transaction with a customer of a broker or dealer if such broker or dealer is not acting as an investment adviser in relation to such transaction; or

(4) to engage in any act, practice, or course of business that is fraudulent, deceptive, or manipulative. The SEC is authorized to adopt rules reasonably designed to prevent such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative.

As noted above, section 206 applies to all investment advisers and their relationship with both U.S. and non-U.S. clients. In addition, section 207 of the Investment Advisers Act further prohibits any willful misstatement or omission of material fact in any registration application or report filed with the SEC.[93]

In marketing to and providing services to Latin American clients, U.S. advisers should note that section 206 is broad enough to prohibit investment advisers from (1) making false or misleading statements to prospective or actual clients, including those for which advisory services are provided indirectly through pooled investment vehicles; or (2) otherwise defrauding those investors.

To the extent an investment adviser provides advisory services to Latin American clients indirectly through a pooled investment vehicle (whether domiciled in the United States or offshore), advisers should also consider the implication of Rule 206(4)-8 of the Investment Advisers Act. Rule 206(4)-8 prohibits registered advisers (and certain unregistered advisers) to pooled investment vehicles from (i) making

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93. 15 U.S.C. § 80b-7 (2011).

false or misleading statements of material fact to current or prospective investors, or (ii) engaging in any other fraudulent conduct with respect to a fund's investors. It should be noted that Rule 206(4)-8 protects prospective investors in funds and it is broad enough to prohibit misleading statements made in offering circulars or private placement memoranda.

The rule also prohibits, for example, materially false and misleading statements regarding investment strategies the pooled investment vehicle will pursue; the experience and credentials of the adviser and its associated persons; the risks associated with certain investments; the performance of the pool or other funds under advisement; the valuation of the pool or the investor accounts in the pool; and the practices the adviser follows, including how the adviser allocates investment opportunities.

[B] Fiduciary Duty Owed to All Clients

In addition to the general anti-fraud provisions of section 206, section 206 of the Investment Advisers Act has been interpreted by the SEC and U.S. courts to impose a fiduciary duty on investment advisers with respect to all of their clients, including non-U.S. Latin American clients.[94] While this fiduciary duty is not specifically set forth in the Investment Advisers Act or in SEC rules, the duty cannot be negotiated or waived away by contract, since the duty is imposed on an investment adviser with respect to all of its clients by operation of law, due to the nature of the relationship between the parties.[95] There are a number of duties that a U.S.-based registered adviser owes to its clients, including its Latin American clients, that stem from its fiduciary duty.

As a fiduciary, an investment adviser is required to act in good faith solely in the best interests of its clients, and to make full and fair disclosure of all material facts. In light of this duty, an adviser is held to a higher standard than mere commercial transactions and has

94. *See* SEC v. Capital Gains Res. Bureau, Inc., 375 U.S. 180, 191–92 (1962) (noting that the Investment Advisers Act reflects a congressional recognition of the delicate fiduciary nature of an investment advisory relationship as well as a congressional intent to eliminate, or at least to expose, all conflicts of interests which might incline an investment adviser—consciously or unconsciously—to render advice that was not disinterested); *see also* Transamerica Mortg. Advisors v. Lewis, 444 U.S. 11 (1979) (noting that the legislative history of the Investment Advisers Act leaves no doubt that Congress intended to impose enforceable fiduciary duties on advisers).

95. *See* In the Matter of Arleen W. Hughes, Exchange Act Release No. 4048 (Feb. 18, 1948); *see also* Morris v. Wachovia Sec., Inc., 277 F. Supp. 2d 622 (E.D. Va 2003) (noting that section 206(2) of the Investment Advisers Act establishes a fiduciary duty for investment advisers).

an obligation to (i) render disinterested and impartial advice; (ii) make suitable recommendations to clients in light of their needs and investment objectives; (iii) exercise a high degree of care in dealing with client transactions; and (iv) have an adequate basis for its recommendations.[96]

[C] Disclosure Obligations

Sections 206(1) and (2) of the Investment Advisers Act have been interpreted to broadly require an investment adviser to disclose all material facts, especially conflicts or potential conflicts of interest in which the investment adviser's interests may not be aligned with those of its clients.[97] The Investment Advisers Act was designed to ensure that conflicts of interest are disclosed to clients and prospective clients in order to give them the choice whether to hire the investment adviser or to take steps to protect themselves.[98] These disclosure requirements apply equally to non-U.S. clients as well as U.S. clients.

While an investment adviser may effect transactions in which the adviser has a personal interest if appropriate disclosure has been made to clients (including its Latin American clients), the adviser must continue to act at all times in the client's best interest, and may not affect transactions that benefit the adviser to the detriment of the client, even where full disclosure of the conflict has been made to the client or potential client. No matter how much disclosure of a material conflict of interest is made by an adviser to the adviser's clients and potential clients, it is possible that the SEC and its staff may view the disclosures made as inadequate and, therefore, any client consent based on such disclosure would be inappropriate.

U.S. advisers dealing with Latin American clients may also have additional disclosure requirements that are dictated by the laws of the local jurisdiction that govern the adviser's client; these local laws may differ significantly from those requirements enumerated by the Investment Advisers Act and the SEC. To the extent a non-U.S. jurisdiction has disclosure requirements that do differ from the Investment Advisers Act, a U.S. adviser may be required to do a "gap-analysis" to determine whether the non-U.S. client is being provided with the correct disclosure mandated by both U.S. and non-U.S. laws governing the substantive relationship between the adviser and the non-U.S. client.

From the perspective of the Investment Advisers Act, an investment adviser has the duty to disclose, among other things, the following to non-U.S. clients:

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96. *See* O'Hanlon, *supra* note 85.
97. *Id.*
98. *See* In the Matter of Arleen W. Hughes, Exchange Act Release No. 4048 (Feb. 18, 1948).

- the various capacities in which the adviser might act when dealing with any particular client, for example, in dealing with affiliated broker-dealers for the client's account, including any compensation the investment adviser would receive from the broker-dealer in connection with a transaction;
- if utilizing an affiliated broker-dealer, the client's ability to execute recommended transactions through other brokers or dealers;
- if the adviser is employed by a broker-dealer, whether the adviser's advisory activities are independent from the adviser's employment with the broker-dealer;
- any compensation received from the issuer of a security being recommended; and
- if charging a fee that exceeds industry norms, that comparable services may be available elsewhere at a lower fee.

These disclosures may be made generally in the adviser's Form ADV Part 2, as discussed below, or in the investment management agreement (or, with respect to advisers to investment funds, in a fund's offering document).

Rule 204-3 under the Investment Advisers Act (the "Brochure Rule") requires that a registered adviser deliver to clients a plain English, narrative brochure containing the information required by Part 2A of Form ADV, as well as a brochure supplement containing the information required by Part 2B of Form ADV.[99] U.S. advisers must deliver this brochure to a client, including Latin American clients, before or at the time of entering into the advisory contract with such client. With respect to such clients, U.S. advisers must also annually either deliver (i) an updated brochure together with a summary of all material changes, or (ii) a summary of all material changes together with an offer to deliver the full updated brochure upon request.[100]

Under the Brochure Rule, a U.S. adviser is not required to deliver a brochure or brochure supplement to any clients (both U.S. and non-U.S.) who receive only impersonal investment advice for which the adviser charges less than $500 per year.[101] With respect to those

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99. Part 2A of Form ADV requires the inclusion of information about the adviser's business, conflicts of interest and disciplinary information (if any). Part 2B of Form ADV requires the inclusion of information about the supervised persons with responsibility for providing investment advice on behalf of the adviser. Any brochure (but not the brochure supplement) delivered to the client must also be filed with the SEC.
100. Rule 204-3(b).
101. Rule 204-3(c).

clients for which an adviser has an obligation to deliver a brochure and brochure supplement under the Brochure Rule, an adviser may satisfy this obligation through electronic delivery.[102] When the adviser is providing advisory services indirectly to non-U.S. clients through a pooled product (for example, a UCITS), an adviser should comply with the Brochure Rule by providing a copy of the brochure to the board of directors or management company of the non-U.S. fund. Although the delivery of a brochure may satisfy an adviser's obligation under the Brochure Rule, compliance with the Brochure Rule does not guarantee that an adviser has satisfied its full disclosure obligations under the U.S. anti-fraud rules.[103]

[D] Fees

In connection with charging fees to non-U.S. clients for advisory services, an adviser should be aware of the following:

- *Fee Disclosure*. Standard fees of the adviser must be disclosed in the Part 2 of Form ADV with a statement as to whether they are negotiable.
- *Debiting Fees.* If a U.S.-registered adviser is permitted to debit its fees from the client account, it will be deemed to have "constructive custody" of client assets and must comply with the Investment Advisers Act rule governing custody.[104]
- *Layering of Fees*. Investing a client's managed account assets into a fund or additional strategy also managed by the adviser, where this has the effect of increasing the adviser's fees, may raise fiduciary issues.[105] The SEC has permitted a client's managed account assets to be invested in a non-money market fund managed by the adviser or an affiliate when it could be demonstrated that the dual fees pertained to services provided in different capacities and did not create any special conflicts of interest, and provided further that the adviser obtained the client's consent to the transaction and disclosed the arrangement in writing.[106]

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102. For a discussion regarding the Commission's guidance on the use of electronic media to fulfill investment adviser disclosure obligations, see Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers for Delivery of Information, Investment Advisers Act Release No. 1562 (May 9, 1996).
103. *See* Form ADV Part 2, Note 3.
104. Rule 206(4)-2(c)(1)(ii) under the Investment Advisers Act.
105. EF Hutton & Co, Inc., SEC No-Action Letter (Nov. 17, 1983).
106. *See* Neuberger & Berman, SEC No-Action Letter (Mar. 30, 1987).

- *Performance Fees*. The one area where the SEC has granted relief from the substantive provisions of the Investment Advisers Act with respect to the relationship between a U.S. based registered adviser and a non-U.S. client is the subject of performance fees. A registered adviser may charge performance fees only to its non-U.S. clients,[107] "qualified purchasers,"[108] knowledgeable employees, or certain other sophisticated persons known as "qualified clients."[109] The investment adviser should obtain appropriate representations from the client as to the client's status within the scope of this exemption.

- *Termination Fees*. Generally speaking, termination fees (or penalties) are not permissible if their sole or primary purpose is to cause the client not to fire the investment adviser.[110] However, liquidated damages are permissible in order to reimburse the adviser for efforts already undertaken or fees earned but not vested.[111]

[E] Cash Solicitation Rule

Rule 206(4)-3 under the Investment Advisers Act (the "Cash Solicitation Rule") generally prohibits a registered adviser from paying a fee to a "solicitor" who has obtained clients for the adviser, unless certain conditions are met. For purposes of the Cash Solicitation Rule, a "solicitor" is considered to be anyone who, directly or indirectly, solicits any client for, or refers any client to, an adviser, including non-U.S. clients. When utilizing a solicitor, U.S. advisers have an obligation to supervise the solicitor and its activities.[112]

In general, in order to pay a fee to a solicitor: (i) the adviser must be registered under the Investment Advisers Act; (ii) the solicitor may not itself be subject to "statutory disqualification" as an investment

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107. Investment Advisers Act § 205(b)(5).

108. Investment Advisers Act § 205(a). A "qualified purchaser" is a sophisticated investor qualified to invest in commingled funds exempt from U.S. registration. Investment Company Act § 2(a)(51)(A).

109. Investment Advisers Act Rule 205-3(a). This provision does not apply to unregistered advisers. Section 205(a) of the Advisers Act.

110. National Deferred Compensation, Inc., SEC No-Action Letter (pub. avail. Aug. 31, 1987) (noting that an adviser may not fulfill its fiduciary obligations if it imposes a fee structure penalizing a client for deciding to terminate the adviser's service or if it imposes an additional fee on a client for choosing to change his investment).

111. *See* Constellation Financial Management, LLC, SEC No-Action Letter (pub. avail. Jan. 9, 2003); Stephenson and Co., SEC No-Action Letter (pub. avail. Dec. 29, 1980).

112. *See* Requirements Governing Payments of Cash Referral Fees by Investment Advisers, Investment Advisers Act Release No. 688 (July 12, 1979).

adviser under the Investment Advisers Act;[113] (iii) any fees must be paid pursuant to a written agreement that, among other things, describes the solicitation arrangement and the compensation to be paid; and (iv) the solicitor must provide to any potential client, including a non-U.S. client, at the time of solicitation, copies of both (a) the adviser's current brochure, and (b) a disclosure statement describing the terms of the solicitation agreement between the adviser and the solicitor (including information as to fees paid and compensation received by the solicitor or the adviser).[114] As part of its recordkeeping obligations, the adviser must keep on file the signed, written confirmation that the client has received the disclosure materials.

In offering advisory services indirectly through a pooled investment vehicle, it is important to note that the SEC staff has clarified that the Cash Solicitation Rule does not apply to a registered investment adviser's cash payments to a person soliciting investors solely to invest in an investment pool managed by the investment adviser, such as a hedge fund, a private equity fund, or even a UCITS.[115] While the Cash Solicitation Rule may not technically apply to the solicitation of prospective investors in a pooled vehicle, investment advisers should take caution in this area and consider carefully their obligations under the general anti-fraud provisions of the Investment Advisers Act, including Rule 206(4)-8.

[F] Advertising

Rule 206(4)-1 under the Investment Advisers Act prohibits a registered adviser from using an advertisement that contains any untrue statement of a material fact, or which is otherwise false or misleading.[116] Rule 206(4)-1 applies equally to a U.S. adviser's existing and prospective clients that are located in the United States and abroad.

Under Rule 206(4)-1, an "advertisement" is defined as "any notice circular, letter or other written communication addressed to more than one person, or any notice or other announcement in any publication or by radio or television, which offers (1) any analysis, report or publication concerning securities, or (2) any graph, chart, formula or other device to be used in making any determination as to

113. Please note, however, that the SEC staff has indicated that a statutorily disqualified person may act as a solicitor under the Cash Solicitation Rule where certain disclosures are made to the prospective client. *See* Dougherty & Company LLC, SEC No-Action Letter (July 3, 2003).

114. We note where the solicitor is an employee of the adviser, the solicitor is under no obligation to provide the brochure or additional disclosure statement.

115. *See* Mayer Brown LLP, SEC No-Action Letter (July 15, 2008).

116. Investment Advisers Act Rule 206(4)-1(a)(5).

when to buy or sell any security, or which security to buy or sell, or (3) any other investment advisory service with regard to securities."[117] The SEC staff has indicated that it does not take the position that a written communication by an adviser that does no more than respond to an unsolicited request would constitute an "advertisement" for purposes of Rule 206(4)-1.[118]

In addition to the broad prohibition against false or misleading advertisements noted above, Rule 206(4)-1 specifically prohibits an advertisement from (i) using a testimonial of any kind concerning the adviser or its advice, analysis, or reports; (ii) referring to past specific recommendations, unless such document includes a list of all recommendations made during the previous year; (iii) containing graphs, charts, formula, or other devices that can, in and of themselves, be used to determine which securities to buy or sell; and (iv) containing a statement that a report or analysis can be had free of charge, unless the adviser is actually providing such report or analysis entirely free and without any condition or obligation.[119]

With respect to performance advertisements, an adviser may present its historical performance information for its various investment strategies, provided that the performance presented is accurate and that the presentation is not false or misleading. The determination as to whether a particular advertisement is false or misleading depends on the facts and circumstances involved in its use, including: (i) the advertisement's form and content; (ii) the implications or inferences arising out of the advertisement's total context; and (iii) the sophistication of the prospective client.[120] In addition, an advertisement containing performance may be considered misleading if it fails to disclose material facts, the omission of which causes the advertisement to imply something about an adviser's ability or competence.[121] Recently, the SEC staff has indicated that an adviser's use of social media (for example, Twitter) to communicate with clients (both existing and prospective) may implicate Rule 206(4)-1.[122]

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117. Investment Advisers Act Rule 206(4)-1(b).
118. Investment Counsel Association of America, SEC No-Action Letter (Mar. 1, 2004).
119. Investment Advisers Act Rule 206(4)-1(a)(1)–(4).
120. *See, e.g.*, Covato/Lipsitz, Inc., SEC No-Action Letter (Oct. 23, 1981).
121. *See* Clover Capital Management, Inc., SEC No-Action Letter (Oct. 28, 1986). For example, an advertisement that fails to disclose the effect of material market or economic conditions is likely to be misleading.
122. *Investment Adviser Use of Social Media*, NAT'L EXAMINATION RISK ALERT, vol. II, issue 1, Jan. 4, 2012, *available at* www.sec.gov/about/offices/ocie/riskalert-socialmedia.pdf.

U.S. registered advisers that market to Latin American clients also should be mindful of the local licensing, advertising, and shareholder protection laws that may exist in the jurisdiction of the client or investor. While a U.S. registered adviser may prepare marketing materials that are in accordance with U.S. law, the ability to utilize those same materials in a foreign market may be limited and/or require the content of the materials to be changed to conform with the requirements of local law.

Registered advisers should consider, on a country-by-country basis within Latin America, what types of materials may be used, what types of investors and/or intermediaries the adviser may target with the materials (if they may be used at all), and the extent to which the use of marketing materials may otherwise impact the adviser's ability to utilize an available exemption that may be premised on no or limited marketing or advertising in that particular market.

[G] Suitability

As is the case in the broker-dealer context, investment advisers owe their clients a duty to provide only suitable investment advice. This duty generally requires an investment adviser to determine that the investment advice it gives to a client is suitable for the client, taking into consideration the client's financial situation, investment experience, and investment objectives.[123] Advisers should consider at all times the suitability of an investment product for a Latin American client, including whether the product is tax efficient. Advisers should also consider suitability obligations that may apply under the local law of the client's/investor's residence or domicile.

[H] Wrap Fee Programs

Many U.S. registered advisers participate in global wrap fee programs. Registered investment advisers should consider on a facts-and-circumstances basis whether accepting a mandate to manage assets for a Latin American client participant in a global wrap fee program will otherwise subject the adviser to registration or authorization in the Latin American jurisdiction of the participant. This country-by-country analysis will often be dictated by the type of wrap account program, the level of contact that may exist between the U.S. registered adviser and the wrap account participant, and whether the adviser has contractual privity with the wrap account participant (in addition to the wrap account sponsor). As a result of a number of hybrid wrap account programs, this country-by-country analysis can be complex.

123. Investment Advisers Act Release No. 1406 (Mar. 16, 1994).

[I] Contract Issues

While the Investment Advisers Act does not specifically require an investment management agreement to be in writing, general commercial considerations will dictate that a U.S. registered adviser has a contract to provide cross-border advisory services for any non-U.S. client, including those resident in Latin America.

Often, the non-U.S. client will provide a form of agreement to be utilized in formalizing the relationship. U.S. registered advisers should carefully consider the type of non-U.S. client (for example, a pension fund or a sovereign wealth fund) in evaluating the contractual terms of any investment management agreement, including contractual terms relating to choice of law, conflicts of laws, forum, service of process, indemnification, compliance with applicable law, and dispute resolution. Careful drafting will help define the rules of the game with respect to the validity and enforceability of the investment management agreement to the extent that a dispute arises.

It is also important to note that the Investment Advisers Act requires an advisory contract with a registered investment adviser to state that the adviser shall not "assign" the investment management agreement without the client's consent.[124] This provision applies equally to non-U.S. clients.

[J] Know-Your-Customer Obligations

Investment firms are responsible for complying with all AML requirements to which they are subject in dealing with clients. When offering advisory services globally to non-U.S. clients, an adviser should focus on its compliance obligations with know-your-customer requirements both under U.S. law as well as the laws of the client to the extent applicable. Failure to do so could subject an investment adviser to severe reputational harm as well as civil and criminal penalties.

On October 26, 2001, President George W. Bush signed into law the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act (the "USA PATRIOT Act").[125] Title III of the USA PATRIOT Act included a significant number of amendments designed to enhance and strengthen the Bank Secrecy Act of 1970, as amended (BSA), which is the statute that serves as the primary basis for most AML reporting and recordkeeping requirements for financial institutions in the United States.[126]

124. *See* Investment Advisers Act § 205(a)(2).
125. *See supra* note 77.
126. Currency and Foreign Transactions Reporting Act of 1970, Pub. L. No. 91-508, 84 Stat. 1118, tit. II (Oct. 26, 1970).

Section 352 of the USA PATRIOT Act requires all "financial institutions," as such term is defined in the BSA, to implement an AML program that includes: (i) development of internal policies, procedures, and controls; (ii) the designation of a compliance officer; (iii) an ongoing employee training program; and (iv) an independent audit function to test the program.[127]

The BSA's definition of "financial institution" is extremely broad, and includes a number of entities that may be subject to AML program obligations under section 352 of the USA PATRIOT Act. The definition includes, among other things, banks, trust companies, investment companies, currency exchanges, operators of credit card systems, loan and finance companies—and even automobile dealers. However, the BSA's definition of "financial institution" does not include investment advisers.

The BSA nevertheless authorizes the Secretary of the Treasury to include additional types of entities within the definition of "financial institution" if the Secretary determines that they engage in an activity "similar to, related to, or a substitute for" an activity of an entity listed in the statutory definition. In 2003, Treasury Department's Financial Crimes Enforcement Network ("FinCEN") invoked this authority to propose an AML program rule that would have covered certain types of federally-regulated and state-regulated investment advisers. However, the proposed rule, along with a related rule that would have required "unregistered investment companies" to implement AML programs, raised numerous concerns from industry representatives—principally because the proposals were attempting to create new definitions of "investment advisers" and "unregistered investment companies" that were not recognized in the federal securities laws. Accordingly, FinCEN formally withdrew the proposed rules in 2008, noting that FinCEN would continue to consider "whether and to what extent it should impose requirements under the BSA on investment advisers and similar entities."

FinCEN recently has announced an intention to issue proposed rules that would require certain investment advisers to implement an AML program that complies with the BSA, and to file suspicious activity reports with FinCEN.[128] These proposed rules are likely to require new or enhanced know-your-customer policies and procedures for U.S. registered investment advisers.

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127. 31 U.S.C. § 5318(h).

128. Regulatory Information Service Center, Introduction to the Unified Agenda of Federal Regulatory and Deregulatory Actions, 77 Fed. Reg. 7664, 7818 (Feb. 13, 2012).

§ 49E:5 Navigating Local Latin American Regulatory Requirements

Any U.S. firm that wishes to offer brokerage services, advisory services, or pooled investment products on a cross-border basis to Latin American clients should have a basic understanding of the laws that apply throughout the client relationship in the client's home jurisdiction. This often requires an adviser to conduct due diligence to determine the regulatory impact on the adviser's business of managing assets for that client, offering brokerage services to that Latin American client, or otherwise offering an investment fund product to that client, as described more fully below.

§ 49E:5.1 Brokerage Services

U.S. broker-dealers providing brokerage services to non-U.S. clients should always consider the application of the laws of the jurisdictions in which the users of the brokerage services are located, including how the U.S. broker-dealer may interact with that customer on an ongoing basis in compliance with local law. This approach often dictates an expensive country-by-country analysis to the application of foreign regulation to the brokerage services provided to the end non-U.S. user. Nevertheless, U.S. broker-dealers should consider the permissibility of providing brokerage services to non-U.S. clients, including through the internet.

U.S. broker-dealers should further consider how brokerage services can be marketed in the local jurisdiction (for example, through cold calls, e-mails, transnational press, airline magazines, etc.), as well as what services and products (for example, mutual funds, options, etc.) can be offered through the brokerage arrangement. For existing non-U.S. customers of the broker-dealer, firms should consider whether the laws of a foreign jurisdiction would allow the broker-dealer to: (i) send accounts statements and confirmations to its current customers; (ii) send general information on brokerage or other services to current customers; (iii) receive from and make unsolicited telephone calls to its current customers; (iv) pay personal visits to its customers in the jurisdiction; and (vi) allow its customers to trade on an internet website sponsored by the broker-dealer.

With respect to online brokerage services that allow Latin American investors to purchase shares of a U.S. or foreign mutual fund through its online facility, a broker-dealer should consider whether it is inadvertently making a public offering of a fund's securities in the jurisdiction of a user, and thereby incurring potential liability for a violation of the local law (and potentially a violation of its contract with the fund purchased by the user), by making it available for trading on its global brokerage platform.

§ 49E:5.2 Offering Advisory Services

In order to determine the extent of the application of local regulation to a U.S. adviser's activities with respect to its Latin American or other non-U.S. clients, a firm must determine, among other things:

- What type of advisory product is being provided and in what form (for example, direct managed account, single purpose managed account in a "pooled" form, model advisory account, sub-advisory account, collective investment fund, etc.)?
- Who will be responsible for contracting with the client (regardless of whether that entity will provide actual portfolio management services)?
- Who will be responsible for managing the advisory account, in terms of providing investment advisory expertise?
- Where will the actual portfolio management take place (for example, from the United States)?
- Who will market the advisory services and in what form?
- To whom it will be marketed (retail individual, high net worth individual, corporate, pension, sovereign wealth fund, etc.)?
- If an entity, how is that prospective client organized and how is it regulated (for example, regulated pension fund)?
- Where are the assets to be invested held in custody and who has discretion over those assets?
- Does the U.S. adviser have locally licensed affiliates that can provide marketing or advisory resources or act as a representative locally?

The answer to these questions (among others) will determine the extent to which the regulatory regime in the client's (or prospective client's) home jurisdiction will apply to a U.S. based registered adviser. The following will examine in more detail the key issues for a U.S. manager to consider when marketing and providing cross-border advisory services to Latin American clients.

[A] Licensing Considerations

In connection with considering whether to provide services to a non-U.S. resident Latin American client, a U.S. adviser should first consider whether the adviser is required to obtain a license (or otherwise be authorized) in the local jurisdiction to provide portfolio management services to the client. Unfortunately, this analysis needs to be conducted on a country-by-country basis depending on the nature of the product being advised (for example, direct separate account, wrap account, pooled investment product, etc.).

In performing this licensing analysis with respect to the ability to offer a separate or managed account to a Latin American client, an adviser should consider the following in determining whether licensing or authorization is required to manage the assets:

- Is the adviser required to be registered to provide cross-border portfolio management services?
- Is the adviser providing services directly or indirectly in a sub-advisory capacity?
- Do the requirements differ if contact was unsolicited?
- Is there an exemption under local law depending on the type of client (for example, an institutional client)? If so, what is it?
- Can the portfolio management take place if on a non-discretionary basis (for example, asset allocation or modeling approach)?
- Can the portfolio management take place if the client contracts with a licensed entity (for example, an affiliate) and discretionary asset management is delegated to the U.S. adviser? If so, are there any restrictions on the delegation to the U.S. adviser?
- Are there any tax implications to the U.S. adviser or the client as a result of the provision of investment management services?
- Do the requirements differ with respect to investments in the account of client (for example, options, futures, commodities or other securities)?

The answer to these questions will determine whether the U.S. registered adviser may provide portfolio management services without being licensed in the client's home jurisdiction, how services may be performed, and if there is any impact on portfolio management other than what is to be agreed upon in the investment management agreement.

[B] Marketing Considerations

In connection with marketing advisory services on a cross-border basis to Latin American clients, a U.S. adviser should first consider whether the adviser is required to obtain a license or otherwise be authorized to market such services in the jurisdiction of the residence of the investor (in addition to being registered or authorized to actually provide portfolio management services). In addition, investment advisers should have a basic understanding of the limitations placed on the adviser by local law in marketing either on a cross-border basis or directly in country.

In marketing its portfolio management services to potential non-U.S. resident Latin American clients, whether directly (in the form of a managed account) or indirectly (in the form of a pooled product), a U.S. adviser should consider the following questions to determine the scope of permissible marketing activities:

- Are there any "broker-dealer" type registration requirements in connection with the marketing by a U.S. adviser of portfolio management services or a fund product?
- Does the product need to be registered to offer the product on a solicited basis (for example, mutual fund, collective investment trust etc.) or its sponsor (for example, wrap account sponsor)?
- Are there any additional marketing regulations?
- May a U.S. adviser respond to an unsolicited Request for Proposal (RFP)?
- May representatives of a U.S. adviser conduct in-person marketing visits in the client's jurisdiction?
- May representatives of a U.S. adviser conduct in-person marketing visits offshore (that is, outside the client's jurisdiction)?
- Is sending unsolicited direct mail permitted?
- Is cold-calling permitted?
- Can marketing be done by way of a website?
- Can marketing be done by means of other electronic communications (for example, e-mail)?
- May representatives of a U.S. adviser speak at industry conferences in the jurisdiction?
- Do the laws and regulations of the potential client's jurisdiction impose any requirements with respect to the language of marketing materials?
- Are there any prescribed disclosures in marketing materials required?
- Are there any restrictions as to the scope of potential investors to whom portfolio management services may be marketed?
- Are there any exemptions that can be utilized (for example, direct reverse inquiry, cross-border exemption etc.)?
- How are consultant and financial intermediaries treated with respect to the licensing of marketing in a particular jurisdiction?

While the answers to these questions will provide a U.S. registered adviser with a roadmap to permissible marketing activities, the map must be constructed on a country-by-country basis.

[C] Client Servicing Considerations

In providing client servicing to any non-U.S. Latin American resident client (whether in a managed account or in a pooled investment vehicle), a U.S. adviser should consider the following in conducting is licensing analysis:

- May a U.S. adviser service clients onshore in the investor's jurisdiction, or is a local licensed intermediary required to service the client?
- May a U.S. adviser service clients from offshore in another jurisdiction outside the United States?
- May a U.S. adviser service clients from offshore via an onshore affiliate? If so, what are the licensing requirements?
- Are there any reporting requirements under local law with respect to the client relationship?

While an exemption may exist that a U.S. registered investment adviser may rely upon to provide cross-border portfolio management services without being licensed in the client's home jurisdiction, a separate exemption may not be available to "service" the client in its home country.

[D] Other Considerations

A U.S. adviser should also consider other material issues that may impact its ability to market to, or provide cross-border advisory services to, non-U.S. clients, or service those clients, including the following:

- Are there any prescribed disclosures or specific terms to be contained in the investment management contract under which services are supplied?
- Are there any ongoing regulatory requirements or other rules which are applicable?
- Are there any requirements as to the governing law of the agreement?
- Are there any requirements as to the language of the agreement?
- Are there any "doing business" requirements in the client's jurisdiction (that is, where "doing business" means holding out to the public and conducting activities within the jurisdiction in question that may be seen as creating a permanent establishment in the jurisdiction)?

- Are there any visa requirements that would prohibit the U.S. adviser from entering a country to market or provide client services (for example, visa requirements to enter China or another jurisdiction to service an existing client)?
- Are there foreign exchange control restrictions that would impact the client's ability to invest outside of its own country?
- Are there requirements that would restrict a U.S. adviser from buying certain securities within the client's account that would otherwise not be contained in the investment management agreement?
- Are there any applicable requirements governing investment advisory agreements, including any formalities required for a client to confer investment discretionary authority?
- Would a U.S. adviser be subject to local laws and regulations in connection with its services for persons outside of its home jurisdiction (for example, a Singapore investor resident in New York that invests from New York)?

§ 49E:5.3 Offering Pooled Products Directly

To the extent a U.S. investment firm wishes to offer pooled products to Latin American clients directly in the country, a firm should consider, among other things: (i) fund registration issues for the product being marketed or sold in the jurisdiction; (ii) broker-dealer type licensing in the jurisdiction in connection with any sales activity that takes place between the firm and the Latin American customer; (iii) the type of investor and whether it is subject to additional regulation or restriction on investing (for example, certain Latin American pension funds and insurance companies); (iv) distribution channels; (v) foreign currency exchange control restrictions; and (vi) certain cultural considerations and investor preferences. An analysis of these considerations, as in the advisory and brokerage context, will require a detailed survey of the laws of each Latin America jurisdiction on a country-by-country basis.

§ 49E:6 Foreign Corrupt Practices Act

U.S. firms offering investment products in Latin America (and elsewhere), should be very familiar with the Foreign Corrupt Practices Act (FCPA), and have policies and procedures in place to implement the FCPA.[129] Over thirty years have passed since its enactment, and it

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129. Foreign Corrupt Practices Act of 1977, 15 U.S.C.§§ 78dd-1 *et seq.* (1977).

remains more important than ever to have in place a compliance program that addresses FCPA concerns, as evidenced by the recent increase in the number of U.S. Department of Justice (DOJ) and SEC investigations into violations of the FCPA.[130] Because of the origins of the FCPA, however, there is a common misconception—shared by many investment advisers—that the FCPA applies *exclusively* to public companies. In fact, the FCPA has a much broader scope and applies to both U.S. investment advisers and their business partners seeking investments from foreign government entities.[131]

The FCPA's anti-bribery provisions are implicated when, among other things, an investment adviser or its partners give money or "anything of value" to three categories of recipients: (i) a foreign official; (ii) a "foreign political party or official thereof or any candidate for foreign political office;" or (iii) any third party, while knowing that the third party, such as a placement agent or finder, will forward the money or thing of value to a recipient in category (1) or (2) above.[132]

Under the FCPA, an investment adviser cannot provide money or anything of value to a recipient in one of the three categories listed above with the "purpose" of: (i) "influencing any act or decision" of a foreign official, foreign political party, or official, or any candidate for

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130. *See, e.g.*, SEC v. Oracle Corp., No. CV-12-4310 CRB (N.D. Cal. Aug. 16, 2012); *In re* Diageo, plc, SEC Release No. 64,978 (July 27, 2011); Press Release, Press Release, SEC, Tenaris to Pay $5.4 Million in SEC's First-Ever Deferred Prosecution Agreement (May 17, 2011), *available at* http://sec.gov/news/press/2011/2011-112.htm; SEC v. Int'l Bus. Machs. Corp., No. 1:11-CV-00563 (D.D.C. Mar. 18, 2011); and SEC v. Elles, No. 1:10-CV-4118 (N.D. Ga. Dec. 20, 2010).

131. *See, e.g.*, Edward L. Pittman, Cheryl A. Krause & Thomas C. Bogle, *Recent SEC Sweep Highlights the Need for U.S. Investment Advisers Seeking Business from Sovereign Wealth Funds to Develop Policies for FCPA Compliance*, J. OF INV. COMPLIANCE (June 22, 2011).

132. 15 U.S.C. §§ 78dd-1(a)(1)–(3), 78dd-2(a)(1)–(3), and 78dd-3(a)(1)–(3). There is ongoing debate over whether the FCPA's definition of "foreign official" encompasses officers or employees of state-owned or state-controlled corporations, although recent cases seem to imply so. *See, e.g.*, United States v. Noriega, No. 10-1031(A)-AHM (C.D. Cal. Apr. 20, 2011).

The FCPA also contains so-called "books and records" accounting provisions. The FCPA's books and records provisions would require advisers that are part of public companies to "make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer," and to "devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that" transactions are properly executed and recorded, and that asset access is limited. *See* 15 U.S.C. § 78m(b)(2)(A) and (B).

foreign office; (ii) "inducing [any of those individuals] to do or omit to do any act in violation of [a] lawful duty;" or (iii) otherwise "securing any improper advantage," or inducing the individual to use his influence with a foreign government or government instrumentality to effect any action.[133]

Per the above definition, anytime an investment adviser seeks a direct or indirect benefit from a foreign official, it comes under the purview of the FCPA. For example, the FCPA applies when an investment adviser seeks an investment from a sovereign wealth fund.[134] One risk in seeking such investments is that absent adequate controls, an employee, business partner, or third-party placement agent of the investment adviser might seek to encourage the investment through improper or illegal means. In such a situation, the investment adviser may be subject to prosecution for violating the FCPA, even if the investment adviser itself had no knowledge of or involvement in such activities being conducted by other parties.[135] To protect against the possibility of such an occurrence, investment advisers should have in place adequate policies and procedures to reduce the risk of FCPA violations. Such procedures should closely follow the guidance developed by the DOJ, the SEC and the U.S. Sentencing Commission.[136]

In addition to U.S. legislation such as the FCPA, advisers seeking business opportunities outside the United States must be attuned to both local licensing requirements and local ethics laws.

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133. 15 U.S.C. §§ 78dd-1(a)(1)–(3), 78dd-2(a)(1)–(3), and 78dd-3(a)(1)–(3).

134. *See, e.g.*, Dionne Searcey & Randall Smith, *SEC Probes Banks, Buyout Shops over Dealings with Sovereign Funds*, WALL ST. J., Jan. 14, 2011; Peter Lattman & Michael J. De La Merced; *SEC Looking into Deals with Sovereign Funds*, N.Y. TIMES DEALBOOK BLOG, Jan. 13, 2011. *See also* U.S. v. Noriega, No. 10-1031(A)-AHM.

135. The first FCPA Advisory Opinion was issued in 2011, in which the DOJ addressed the scope of the FCPA's "promotional expenses" exemption under the FCPA. *See* U.S. Dep't of Justice, Foreign Corrupt Practices Act Opinion Procedure Release 11- 01 (June 30, 2011) (the "Opinion"). The DOJ ultimately found that a U.S. "domestic concern" (the "Requestor"), which sought to pay for the travel of representatives from two foreign agencies to learn about the adoption services provided by the Requestor, had acted "reasonably" under the circumstances. The Opinion is helpful in clarifying the circumstances under which companies can benefit from an exception to FCPA liability for payment of the reasonable travel, food, and entertainment expenses of "foreign officials."

136. *See* Dep't of Justice, Foreign Corrupt Practices Act Review Opinion Procedure Release 04- 02 (July 12, 2004); U.S. SENTENCING COMMISSION, GUIDELINES MANUAL, ch. 8 (Nov. 2011); SEC ENFORCEMENT MANUAL, § 6.1.2.

§ 49E:7 Foreign Account Tax Compliance Act (FATCA)

FATCA was enacted in the United States on March 18, 2010.[137] The legislation was enacted in response to concerns that U.S. taxpayers, through the help of offshore banks and other foreign financial institutions (FFIs), were able to maintain thousands of U.S. accounts containing billions of dollars in assets that went undisclosed to the IRS for purposes of paying U.S. taxes on the resulting income.[138] The new law is designed to assist the U.S. government in discovering the identity of U.S. taxpayers who may be evading U.S. taxes by making U.S. investments through FFIs.[139]

FATCA affects every offshore fund investing in the United States. It imposes a 30% withholding tax on dividends, interest, and other payments made from the United States to FFIs, which by definition includes offshore funds.[140] The withholding tax will not be imposed if the FFI enters into an agreement with the IRS requiring it to (i) adopt new due diligence standards to determine the identity of targeted U.S. owners; (ii) supply information to the IRS regarding its U.S. owners and accountholders; and (iii) withhold the 30% tax on payments made to non-cooperative account holders.[141]

Notably, the definition of "U.S. Person" under FATCA does not match the definition promulgated by the SEC. Under FATCA, a U.S. Person is defined as a U.S. citizen, no matter where s/he resides, as well as all U.S. tax residents. This is a much broader definition than the SEC's concept of U.S. Person, which the SEC defines as any natural person resident in the United States.

On February 8, 2012, the IRS, in conjunction with the U.S. Treasury Department, issued draft FATCA regulations, which are subject to comment.[142] According to the most recent guidance issued by the IRS, an FFI must enter into an agreement with the IRS by June 30, 2013, to ensure that it will be exempt from the withholding tax beginning on January 1, 2014.

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137. Foreign Account Tax Compliance Act, Pub. L. No. 111-147, 124 Stat. 97 (Mar. 18, 2010).
138. *See* 156 Cong. Rec. S1745 (Mar. 18, 2010).
139. *See id.*
140. Pub. L. No. 111-147, 124 Stat. 97 (Mar. 18, 2010).
141. Notice 2011-19, 2011-34 I.R.B. 765.
142. I.R.S. News Release IR-12-15 (Feb. 8, 2012).