



State of Utah

DEPARTMENT OF COMMERCE DIVISION OF SECURITIES

Protecting Investors; Promoting Commerce

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January 12, 1999

Charles S. Gittleman
Shearman & Sterling
599 Lexington Ave.
New York, NY 10022-6069

Re: **Foreign Margin Stocks**
Request for Interpretive Opinion
File # B00098137

Dear Mr. Gittleman:

This letter is in response to your request of November 25, 1998, on behalf of the Securities Industry Association ("SIA") for an interpretive opinion from the Utah Division of Securities ("Division"). You asked the Division to do the following: (1) confirm that all foreign equity securities listed on the Financial Times/Standard & Poors World Actuaries Indices ("FTS&P") will be deemed to be on the list (the "List") of foreign equity securities which are eligible for margin and thereby exempt from registration for secondary trading pursuant to R164-14-23s (the "Rule") of the Utah Administrative Code; (2) confirm that foreign equity securities which are deemed by the SEC to have a "ready market" may be deemed to be on the List for the purposes of the Rule and thereby not subject to registration for secondary trading in Utah. In rendering this opinion, the Division assumes, without deciding, that the following facts are true:

- Since 1990, the Board has published a list (the "List") of foreign equity securities which are eligible for margin. According to Regulation T, foreign equity securities are initially eligible for inclusion on the List if the issuer of such securities meets certain threshold criteria relating to trading volume, trading history and market capitalization. For continued eligibility, the issuer must maintain a minimum level of trading volume and market value for the security.
- In June of 1995, the Board sought comment on a proposal to develop additional, alternate criteria for determining which foreign equity securities would qualify as foreign margin stock. Under this proposal, the Board would continue to publish the List based on the original eligibility criteria, but the List would also incorporate foreign equity securities that have a "ready market" as that term is defined pursuant to Rule 15c3-1. On May 6, 1996, in response to favorable commentary, the Board adopted

the proposal. In implementing its new proposal, the Board incorporated the Financial Times/Standard & Poor's World Actuaries Indices (the "FTS&P") into the List in reliance upon a No-Action Letter issued by the SEC which effectively treats all securities on the FTS&P as having a "ready market" for purposes of the Net Capital Rule.

- In January of 1998, the Board went one step further in supporting the eligibility for margin of foreign equity securities having a "ready market" by expanding the definition of foreign margin stock. Effective April 1, 1998, the definition of foreign margin stock in Section 220.2 of Regulation T was altered to include not only foreign equity securities appearing on the List as periodically published by the Board, but also any foreign equity security deemed to have a "ready market" under Rule 15c3-1 or a "no-action" position issued thereunder. However, rather than permit a broker-dealer to make its own determination that a particular security has a "ready market", in its ruling the Board indicated that it viewed "the process of increasing coverage of its definition as an incremental one" and limited broker-dealers to rely upon written "no action" or interpretive letters issued by the SEC that determine whether a particular foreign equity security or group of foreign equity securities has a "ready market" within the meaning of the Net Capital Rule.
- Since the Board's definition of foreign margin stock has changed, it is no longer necessary for the Board to specifically include the FTS&P foreign equity securities or any other foreign equity securities with a "ready market" in the List. The Board will maintain its original eligibility requirements in addition to the new criteria and the List will continue to exist alongside those foreign equity securities eligible as foreign margin stock because they have a "ready market." As a consequence of this amendment (the "1998 Amendment"), broker-dealers can extend credit to customers to purchase qualifying "ready market" foreign equity securities whether or not they are formally cited on the List as long as they are deemed "ready market" by the SEC in a no-action position or an interpretive letter as explained above.

Analysis

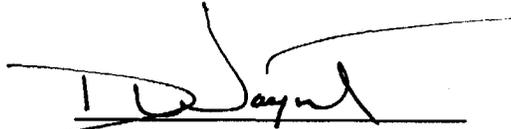
The Division has the authority to enact rules regarding the registration of securities. UCA 61-1-7, 61-1-24. Pursuant to that authority, the Division has enacted Rule R164-14-23s (the "Rule"), which "provides an exemption for secondary market transactions in securities offered by foreign issuers satisfying the requirements of this rule." UAC R164-14-23s(A)(2). The Rule states that "continued registration is not necessary . . . [if] (1)(a) the security appears in the most recent Federal Reserve Board List of Foreign Margin Stocks" UAC R164-14-23s(C)(1).

As the SIA correctly points out, the Rule was adopted before the changes, discussed above, by the Board of Governors of the Federal Reserve System (the "Board") regarding foreign margin stocks. The Division takes the position that the Board's changes are fair and

reasonable, and that it would be in the best interest of Utah investors to incorporate those changes into the Division's interpretation of the Utah Rule.

Accordingly, the Division confirms that all foreign equity securities listed on the Financial Times/Standard & Poors World Actuaries Indices ("FTS&P") will be deemed to be on the list (the "List") of foreign equity securities which are eligible for margin and thereby exempt from registration for secondary trading pursuant to R164-14-23s (the "Rule") of the Utah Administrative Code. The Division further confirms that foreign equity securities which are deemed by the SEC to have a "ready market" may be deemed to be on the List for the purposes of the Rule and thereby not subject to registration for secondary trading in Utah.

Respectfully,

A handwritten signature in black ink, appearing to read "D. Wayment", written over a horizontal line.

David H.T. Wayment
Senior Legal Counsel

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WRITER'S DIRECT NUMBER:

(212) 848-7137
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November 25, 1998

VIA AIRBORNE EXPRESS

Mr. S. Anthony Taggart, Director
Department of Commerce
Utah Division of Securities
160 East 300 South, 2nd Floor
Salt Lake City, Utah 84111

Foreign Margin Stocks

Dear Mr. Taggart:

We are writing on behalf of the Securities Industry Association¹ ("SIA") and pursuant to R164-25-5 of the Utah Uniform Securities Act (the "Utah Act") to request confirmation from the Division that R164-14-23s(2)(C)(a) (the "Rule") of the Utah Act may be interpreted to take into consideration certain changes in the manner in which the Board of Governors of the Federal Reserve System (the "Board") determines the eligibility of foreign equity securities for margin. Enclosed please find this firm's Check No. 397563 in the amount of \$120.00 to cover the required filing fee.

As you may be aware, the Board recently made comprehensive revisions to Regulations G, T and U. The revisions govern, among other things, the extension of credit in

1 The Securities Industry Association brings together the shared interests of nearly 800 securities firms, employing more than 380,000 individuals, to accomplish common goals. SIA members—including investment banks, broker-dealers, and mutual fund companies—are active in all markets and in all phases of corporate and public finance. The U.S. securities industry manages the accounts of more than 50 million investors directly and tens of millions of investors indirectly through corporate, thrift and pension plans and accounts for \$270 billion of revenues in the U.S. economy.

securities-related transactions and activities. In specific regard to determining which foreign stocks are eligible for extension of margin credit, the Board has amended its approach to include any stock deemed by the Securities and Exchange Commission (the "SEC") to have a "ready market" under Rule 15c3-1 of the Securities Exchange Act of 1934, as amended ("Rule 15c3-1" or the "Net Capital Rule") or a "no action" position issued thereunder by the SEC.

Background

Since 1990, the Board has published a list (the "List") of foreign equity securities which are eligible for margin. According to Regulation T, foreign equity securities are initially eligible for inclusion on the List if the issuer of such securities meets certain threshold criteria relating to trading volume, trading history and market capitalization. For continued eligibility, the issuer must maintain a minimum level of trading volume and market value for the security.²

In June of 1995, the Board sought comment on a proposal to develop additional, alternate criteria for determining which foreign equity securities would qualify as foreign margin stock.³ Under this proposal, the Board would continue to publish the List based on the original eligibility criteria, but the List would also incorporate foreign equity securities that have a "ready market" as that term is defined pursuant to Rule 15c3-1.⁴ On May 6, 1996, in response to favorable commentary, the Board adopted the proposal.⁵ In implementing its new proposal, the Board incorporated the Financial Times/Standard & Poor's World Actuaries Indices⁶ (the "FTS&P") into the List in reliance upon a No-Action Letter issued by the SEC which effectively

2 12 C.F.R. Part 220 (1998). (See Exhibit A)

3 60 Fed.Reg. 33763 (June 29, 1995).

4 17 C.F.R. 240.15c3-1.

5 61 Fed.Reg. 20386 (May 6, 1996). (See Exhibit B)

6 The criteria for determining which equity securities will be cited on the Financial Times/Standard & Poor's World Actuaries Indices are complex and stringent. Briefly, the securities must satisfy five investibility "screens". Approximately 85% of the largest issuers of the stocks which pass the initial five screens will then be selected for inclusion. (See Exhibit C)

treats all securities on the FTS&P as having a "ready market" for purposes of the Net Capital Rule.⁷

In January of this year, the Board went one step further in supporting the eligibility for margin of foreign equity securities having a "ready market" by expanding the definition of foreign margin stock.⁸ Effective April 1, 1998, the definition of foreign margin stock in Section 220.2 of Regulation T was altered to include not only foreign equity securities appearing on the List as periodically published by the Board, but also any foreign equity security deemed to have a "ready market" under Rule 15c3-1 or a "no-action" position issued thereunder. However, rather than permit a broker-dealer to make its own determination that a particular security has a "ready market", in its ruling the Board indicated that it viewed "the process of increasing coverage of its definition as an incremental one"⁹ and limited broker-dealers to rely upon written "no action" or interpretive letters issued by the SEC that determine whether a particular foreign equity security or group of foreign equity securities has a "ready market" within the meaning of the Net Capital Rule.

Since the Board's definition of foreign margin stock has changed, it is no longer necessary for the Board to specifically include the FTS&P foreign equity securities or any other foreign equity securities with a "ready market" in the List. The Board will maintain its original eligibility requirements in addition to the new criteria and the List will continue to exist alongside those foreign equity securities eligible as foreign margin stock because they have a "ready market." As a consequence of this amendment (the "1998 Amendment"), broker-dealers can extend credit to customers to purchase qualifying "ready market" foreign equity securities whether or not they are formally cited on the List as long as they are deemed "ready market" by the SEC in a no-action position or an interpretive letter as explained above.

Analysis

Under the Utah Act, any foreign equity security on the List is exempt from registration for secondary trading in the state. However, since the List no longer represents all foreign equity securities eligible for margin, the SIA believes that an interpretation of the Rule is necessary to take into account the new method by which the Board identifies foreign margin stock.

The SIA requests confirmation that all foreign equity securities listed on the FTS&P be deemed to be on the List and thereby benefit from the exemption from registration for

7 SEC No-Action Letter (August 13, 1993). (See Exhibit D, which also includes the related SEC Release No. 34-32748.)

8 63 Fed.Reg. 2806 (January 16, 1998). (See Exhibit E)

9 *Id.* at 2816.

The SIA requests confirmation that all foreign equity securities listed on the FTS&P be deemed to be on the List and thereby benefit from the exemption from registration for secondary trading pursuant to the Rule. For almost two years prior to the 1998 Amendment, all FTS&P foreign equity securities were in fact on the List and did qualify for the exemption under the Rule. Consequently, unless the Utah Act applies the relevant exemption provision to FTS&P foreign equity securities, hundreds of previously exempt foreign equity securities may become subject to registration. The net effect of this would be to significantly reduce the investment opportunities available to residents of Utah.

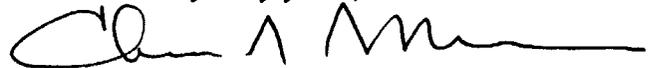
Additionally, the SIA is requesting confirmation that foreign equity securities which are deemed by the SEC to have a "ready market" may be deemed to be on the List for the purposes of the Rule and thereby not subject to registration for secondary trading in Utah. The "ready market" test effectively identifies foreign equity securities that satisfy the Board's intent to ensure liquidity and price transparency for foreign margin stocks. Consequently, because the FTS&P foreign equity securities have already been on the List and because any additional "ready market" foreign equity securities must be passed upon by the SEC before they qualify as foreign margin stock, the SIA believes that an interpretation of the Rule which effectively deems all foreign margin stock identified by the Board to be on the List is appropriate and consistent with the purpose of the exemption. By adopting such an interpretation, the Utah Act would be aligned with the Board's current position with respect to foreign margin stock.

The SIA also requests that the Division consider amending the Rule. In light of the above analysis, it is clear that an amendment of the Rule to adopt the Board's "ready market" test for determining foreign margin stock is not only appropriate, but also within the public interest and consistent with the policy underlying the existing law.

We would appreciate receiving confirmation of this filing on the enclosed copy of our cover letter and your returning it in the attached self-addressed stamped envelope.

Thank you for your attention to this matter. Please do not hesitate to contact me at the number above, or Kristina B. Larson at (212) 848-8691, if you have any questions or need any additional information.

Very truly yours,



Charles S. Gittleman

Enclosures

cc: Mr. Daniel J. Barry
Director of State Regulation & Legislation
Securities Industry Association