New York State Bar Association
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Comments on FINRA's Proposal to adopt the Capitol Acquisition Broker Rules

BUSINESS LAW SECTION
SECURITIES REGULATION COMMITTEE

BLS #2 January 22, 2016

Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re : Release No. 34-76675
File No. SR-FINRA-2015-054
Notice of Filing of a Proposed Rule Change to
Adopt the Capital Acquisition Broker Rules

The Securities Regulation Committee of the Business Law Section of the New York State Bar Association appreciates the invitation from the SEC in Release No. 34-76675 to comment on FINRA's proposal to adopt the Capital Acquisition Broker ("CAB") Rules.

The Committee is composed of members of the New York State Bar Association, a principal part of whose practice is in securities regulation. The Committee includes lawyers in private practice and corporation law departments. A draft of this letter was reviewed by certain members of the Committee. The views expressed in this letter are generally consistent with those of the majority of members who reviewed and commented on the letter in draft form. The views set forth in this letter, however, do not necessarily reflect the views of the organizations with which its members are associated, the New York State Bar Association or its Business Law Section.

Introduction

The Committee supports FINRA's proposal to establish a separate set of rules for CABs. We appreciate the effort FINRA has made to reduce the regulatory burdens on CABs and their supervisory persons, and we urge FINRA to consider two further changes which may take place separately from this rulemaking, to further reduce the burdens on CABs.

First, FINRA should establish a program to approve the membership applications of new CABs within 60 days of the filing of the application, provided that certain conditions are met. Those conditions may include:

- A completed application;

Opinions expressed are those of the Section/Committee preparing this memorandum and do not represent those of the New York State Bar Association unless and until they have been adopted by its House of Delegates or Executive Committee.

- The required supervisory principals, who have each taken and passed the applicable examinations; and

- No significant disciplinary history or other red flag indications of potential compliance problems.

The financial burden on new brokers waiting for registration results not solely from the cost of the application process and the implementation of reasonable supervisory systems, but also from the passage of time during which the new broker is not able to do business.[1] The experience of many lawyers who advise persons considering registration as a broker or dealer is that the length of time required to become registered is as daunting as the cost of registration, and sometimes more so. We are aware that FINRA implemented a fast-track registration process for selected applicants; however, we believe that those preparing to register as CABs should have more certainty about the time required to become a member.

The second change we urge FINRA to consider, outside of the proposed CAB Rules, is to establish new examinations specifically for the registered representatives and supervisory principals of CABs that will test only that subject matter relevant to the business of CABs. We do not dispute the didactic benefits of qualifying examinations, but it is also true that the examinations themselves are a burden and disincentive for persons considering registration. Given the limited nature of the CAB business, the qualifying examination should be similarly limited in scope and length.

Definition of CAB – Secondary Transactions

Subparagraph (1)(E) of the definition of CAB in proposed Rule 016(c) includes, among the permissible activities of a CAB, "qualifying, identifying, soliciting, or acting as a placement agent or finder with respect to institutional investors in connection with purchases or sales of unregistered securities." We read that description as including both primary issuances and secondary transaction in unregistered securities. However, we request that FINRA confirm the intent to include secondary transactions among the permitted activities of a CAB.

In the recently adopted FAST Act, Congress recognized the importance of the accessibility of the secondary market in the securities of startup companies. In Title LXXVI, "Reforming Access for Investments in Startup Enterprises," Congress added a new exemption; Section 4(a)(7), for secondary sales to accredited investors. This exemption, together with Rules 144 and 144A, makes it easier for holders of unregistered companies, including current and former employees and investors in early rounds, to find buyers for their securities at reasonable prices.

There are no special or difference compliance risks posed by secondary transactions in unregistered securities. Because of the benefits to be realized by permitting CABs to assist in secondary sales, and the absence of any significant risks, CABs should be expressly permitted to engage in secondary transactions.

Definition of Institutional Investor

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[1] Please see the section headed "Registration by Exempt M&A Brokers" for a suggestion for reducing the economic impact on M&A Brokers of the transition to registration.

We understand that FINRA considers the limitation on the activity of CABs to transactions with institutional investors to be important to the differential regulation of CABs, and we appreciate that the definition of institutional investor has been expanded to include qualified purchasers as defined in Section 2(a)(51) of the Investment Company Act. We would urge, however, that FINRA permit transactions with certain other categories of persons. Specifically, FINRA should include the following persons to the list of institutional investors:

1) A "knowledgeable employee" as defined in Investment Company Act Rule 3C-5, except that for purposes of the institutional investor definition, "covered company" would mean either the CAB or the issuer of the securities sold in the transaction; and

2) A person designated by the issuer of the securities sold in the transaction, provided that the CAB did not solicit the person or make a recommendation to the person with respect to purchase of the securities.

There may be circumstances where the issuer wishes to sell securities to persons who would not otherwise qualify as institutional investors, but wants the transaction to be effected by the CAB. The CAB rules should not prohibit sales to those categories of persons, since the usual concerns about suitability determinations and content of communications by member firms to retail investors would not apply.

Registration by Exempt M&A Brokers

Some persons act as intermediaries in mergers and acquisitions ("M&A Brokers") for compensation pursuant to the exemption provided by the SEC's M&A Broker No-Action Letter (January 31, 2014). M&A Brokers may decide to register as CABs for various reasons. An M&A Broker that wishes to become a CAB may encounter financial, as well as logistical, hardships if it is required to suspend its business while its application for membership is being reviewed. An M&A Broker should be permitted to continue that business up until the time it becomes a CAB and member of FINRA, with the proviso that all activities after it becomes a CAB must be conducted in compliance with the applicable CAB Rules. We suggest that a new subparagraph (c) be added to Rule 112 providing as follows:

(c) An applicant for membership that has been engaged in activities that would require registration as a broker, but for an exemption for which the applicant meets all of the necessary conditions, may continue to engage in activities permitted by the exemption until its application is approved by FINRA, provided that on and after the date on which the applicant becomes a member, the applicant shall conduct such activities in compliance with the CAB rules and SEC laws and rules applicable to registered brokers.

Prohibition on Private Securities Transactions

Proposed Rule 328 would prohibit persons associated with a CAB from participating in any manner in a private securities transaction as defined in FINRA Rule 3280(e). We believe that Rule 328 should be revised to exclude (1) the investment advisory activities of associated persons who are also employees or supervised persons of an investment adviser registered with the SEC or a state and (2) employees of a bank or trust company engaged in securities or advisory activities that a bank may engage in pursuant to the exceptions from the definition of broker or dealer in Exchange Act Sections 3(a)(4) or (5) of Regulation R.

We expect that some investment advisers, especially those that manage private investment funds, may elect to form an affiliated entity to become a CAB for the purpose of marketing the private investment funds. As is the case now, when advisers have affiliated brokers, some registered representatives of the CAB may also be employees of the adviser and place securities orders for advisory clients. FINRA has advised, in Notices to Members 91-32 and 94-44, that the activities of the employees on behalf of the adviser are to be treated as private securities transactions. If Rule 328 is not revised to permit associated persons of the CAB to provide advisory services on behalf of the advisers, the rule will be a meaningful obstacle to use of the CAB designation by an affiliate of investment adviser.

We believe the same may be true in cases where a bank or trust company wishes to form an affiliated CAB to engage in securities transactions not permitted by the exceptions in section 3(a)(4) or Regulation R. Bank employees who are associated persons of a CAB would be prohibited by Rule 328 from engaging in securities transactions they would otherwise be permitted to engage in under the bank exclusion. While there may be a rationale for prohibiting private securities transactions away from the CAB and not under the supervision of another regulated entity, that rationale does not apply to activities that the associated person would be able to engage in in his or her role as an employee of a regulated entity. We therefore urge FINRA to revise Rule 328 to exclude from its prohibition the activities of investment adviser, bank and trust company personnel acting within their proper roles.

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We are grateful for the opportunity to provide these comments on the proposed CAB Rules and for the attention and consideration of FINRA and the SEC. We would be happy to discuss these comments further with FINRA or the SEC.

Chair of the Committee : Peter W. LaVigne, Esq.

Cc: Philip Shaikun
Joseph Savage
FINRA