RWI

Reliance Worldwide Investments, LLC

April 25, 2014

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

RE: Request for Comment, Regulatory Notice 14-09
Limited Corporate Financing Brokers

Dear Ms. Asquith:

Reliance Worldwide Investments, LLC ("RWI") welcomes this opportunity to comment on the proposed rule set for Limited Corporate Financing Brokers.

RWI is a full service general securities firm, licensed to conduct business in 36 States. The firm generates considerable revenues from investment banking activities. While the majority of these revenues are generated internally, a portion of our overall revenues are produced by independent contractor registered representatives who conduct approved outside business activities as business brokers. The majority of these independent contractors limit their securities practice to clearing the securities of their privately-held company investment banking transactions through our firm.

The vast majority of our investment banking clients are privately-held corporations involved in acquisitions, divestitures, and mergers. Typically, these transactions have a debt and/or equity capital structuring component.

With respect to FINRA's request for comment concerning the following issues:

Question 1. Does the proposed rule set provide sufficient protections to customers of an LCFB? If not, what additional protections are warranted and why?

The protections are sufficient to the extent that an LCFB customer, directly or indirectly, benefits from Rule 209 Know Your Customer, Rule 211 Suitability, Rule 221 Communication with the Public, Rule 324 Borrowing From or Lending to Customers, Rule 327 Outside Business Activities of Registered Persons, Rule 331 Anti-Money Laundering Compliance Program, various supervisory rules etc.

However, our firm would suggest the FTC Red Flag Rule should also apply to LCFBs. Even though there are no covered accounts per se, the LCFB would be in possession of certain confidential and sensitive information regarding their customers. It is reasonably foreseeable that those customers might be exposed to risks associated with identity theft.

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Question 2. Does the proposed rule set appropriately accommodate the scope of LCFB business models? If not, what other accommodations are necessary and how would customers be protected?

To the extent that an LCFB's business model would be providing investment banking services (advising companies regarding the purchase or sale of a business or assets, or corporate restructuring, or divestitures or mergers) to customers who are privately-held corporations, the answer would be no.

An analysis of U.S. companies by size reveals that <u>over ninety-nine percent of businesses generate less than $50 million in annual revenues</u> (U.S. Census Bureau, 2009). Established small to mid-size private businesses (operating for 3 years or more) have annual sales ranging from about $1 million to $75 million. Best estimates indicate there are approximately 8.1 million established businesses in the U.S. Factoring in companies with multiple owners, there are approximately 10.2 million owners. (davemead.blogspot.com/2012/02 baby-boomers-again-think-about-selling.html).

The vast majority of the purchasers of these privately-held companies are <u>private equity groups and accredited investors</u>.

In 2013, nearly 40% of all private equity deals were valued below $25 million while 60% were valued below $100 million (*Pitchbook* 4Q 2013 *Private Equity Breakdown*, p. 9).

There are 2,797 private equity firms headquartered in the United States. The largest investors in private equity include public and private pension funds, endowments and foundations, which accounted for 64% of all investment in private equity in 2012. And, during the last five years, private equity has invested almost $30 Billion in more than 1,987 U.S.-based companies that had filed for bankruptcy. (<u>http://www.pegcc.org/education/fact-and-fiction</u>).

To our firm's knowledge, there is no publicly available information regarding the number of private equity groups that qualify as institutional investors.

If FINRA excludes accredited investors and private equity from the list of potential investors a LCFB could "qualify, identify, and solicit," the pool of potential transaction participants available to LCFBs would be severely limited. Such a limitation would represent a tremendous disadvantage, from a competitive perspective. We are firmly convinced this factor alone would preclude firms that service this substantial marketplace from considering LCFB registration.

Given FINRA's "serious concerns" cited in Endnote 3 to Regulatory Notice 14-09, additional safeguards would be required to adequately protect investors from "the manner in which firms market and sell private placements to accredited investors." Without further specificity on this issue, it is not possible for our firm to provide constructive suggestions regarding additional customer protection, at this time. We find this statement by FINRA quite disturbing, and look forward to the future issuance of applicable guidance, FAQs, etc. on this matter.

From a practical perspective, we strongly urge FINRA to consider allowing LCFBs to conduct business with accredited investors, and incorporate adequate safeguards into the proposed rules addressing the "serious concerns" identified by FINRA regulatory programs. It would also seem prudent to apply those new rules to all applicable Broker-Dealers as well.

I cannot stress strongly enough – our firm believes limiting the parties that could be "qualified, identified, and solicited" to institutional investors (thereby excluding accredited investors and private equity groups), would eviscerate a LCFB's ability to conduct investment banking business in its privately-held customer's best interests.

Question 3. Is the definition of "limited corporate financing broker" appropriate? Are there any activities in which broker-dealers with limited corporate financing functions typically engage that are not included in the definition? Are there activities that should be added to the list of activities in which an LCFB may not engage?

It is always difficult to know when broader terms with "less specificity" provides the best, workable solution. However, other potential activities performed for privately-held companies that might be considered for inclusion would be:

- Advise and assist in preparing a business for sale
- Advise customer regarding the value of the business
- Advise and Assist customer in preparing financial modeling
- Advise about financing alternatives and financial impact
- Assist customer is evaluating prospective/competing offers
- Advise about transaction structures, terms and conditions
- Advise and assist customer in preparing for due diligence
- Advise about commonly recurring business transition issues
- Acting solely as a Finder (introducing potential parties to a transaction)
- Provide expert witness and litigation support services

Question 4. Are there firms that would qualify for the proposed rule set but that would choose not to be treated as an LCFB? If so, what are the reasons for this choice?

Yes. See response to Question 2 above, regarding accredited investors and private equity groups and the limitation imposed by restricting "qualifying, identifying or soliciting" to institutional investors.

Question 5. What is the likely economic impact to an LCFB, other broker-dealers and their competitors of adoption of the LCFB rules?

As proposed, there is di minimis financial advantage to an existing broker-dealer in applying for LCFB registration.

If asked, most FINRA Members would probably tell you they would like to see the direct, and indirect, costs of membership reduced. I'm sure you won't be surprised to know they would also like their taxes to go down as well! However, we are all realistic enough to understand there are costs associated with being in this industry, and that we all have to pay our own fair share. Psychologically, it is always easier to bear that burden if we perceive there is a value proposition created, and substantive benefit provided, as a result of the expenditure of those funds.

In the spirit of that commentary, our firm sees six cost reduction areas FINRA may wish to consider. Some combination of these suggested items and others might go a long way toward creating a value proposition, and thereby increase the attractiveness of an LCFB to prospective candidates:

- PCAOB Audit – Consider establishing criteria under which a "Review" would be conducted, rather than the more expensive PCAOB Audit, such as:
    - Under a certain revenue or asset size
    - Firms who do not borrow money
    - Firms who have no indirect or external investors
    - Firms who do not issue fairness opinions

    As LCFBs do not carry or maintain customer accounts, hold or handle customer funds or securities, exercise discretion over customer accounts, or engage in proprietary trading or market-making, there is less risk to investors associated with this business model.

- SIPC – Reduce or eliminate the requirement for an assessment on privately-held company securities transactions, as it is outside the general scope of intended SIPC insurance protection.

- Fidelity Bond – Reduce or eliminate the requirement for a bond. As stated above, since LCFBs do not carry or maintain customer accounts, hold or handle customer funds or securities, exercise discretion over customer accounts, or engage in proprietary trading or market-making, there is less risk to investors associated with this business model.

- FINRA Revenue Assessment – Reduce the assessment calculation based upon an analysis of the lower cost to FINRA associated with regulatory oversight of an LCFB as compared to other Broker-Dealer business models.

- Net Capital Requirement – For some of the same reasons cited in the PCAOB Audit discussion above, "right-size" the amount.

- Continuing Membership Application process – Reduce the cost, and streamline the process, whereby a LCFB would be able to return to its prior Broker-Dealer status (as long as it met the current requirements of that prior status). The requirements/process as stated in the proposed rule set may very well be perceived as a disincentive to many Broker-Dealers who might otherwise consider LCFB registration.

Question 6. FINRA welcomes estimates of the number of firms that would be eligible for the proposed rule set.

Our firm has no specific estimate, however, it is aware of certain information which may provide some insight on this issue:

- Within the securities industry: On December 20, 2013, FINRA Small Firm Governors Norensberg, Carreno, and Keenan sent an email entitled "Small Firm Update" regarding the FINRA Board of Governors December 2013 meeting. In this email it was stated that the forthcoming LCFB proposal was "expected to affect nearly 700 broker-dealers." No information was provided alluding to the basis for such an expectation. According to Chairman Ketchum's Management Report on Financial Operations, "as of December 31, 2012, FINRA oversaw nearly 4,300 broker firms ..." Therefore, if the 700 broker-dealer number is assumed to be correct, approximately 16.3% of all current FINRA broker-dealer firms would be affected.

- Outside the securities industry: A Business Broker is generally defined as a person who assists individuals in selling or buying a small or mid-size business. The activities of a business broker can range from simply introducing two parties to more complicated functions such as analyzing a business's financial statements, marketing the business for sale, and assisting the client's other advisors in negotiation the terms of a transaction. **It is estimated that there are approximately 3,000 – 4,000 business brokers in the United States**. A business broker is often utilized by companies who are interested in selling, but not large enough to attract the interest of traditional investment banks. Most investment banks work on transactions with companies generating in excess of $100 million dollars in revenues. **An analysis of U.S. companies by size reveals that over ninety-nine percent of businesses generate less than $50 million in annual revenues**. It is this large, underserved market that business brokers service. (http://www.cvbba.com/images/APMAA_Reg_Issues_3-17-2010.pdf)

  Our firm believes business broker firms are typically small businesses composed of one to ten producing brokers. Shane Hansen, an attorney who represents business broker associations testified in a U.S. House of Representatives hearing on June 12, 2013: "Accordingly, a very high percentage of M&A brokers are not registered with the SEC and so, technically, are violating the registration requirements in federal securities laws today." Therefore, our firm believes it would be safe to say that in excess of 300 business brokerage firms would be eligible to become securities licensed, and such firms could potentially qualify under the proposed rule set. Although, we consider it unlikely that any of them would have an interest, in no small part due to the M&A Broker No-Action Letter that was issued by the SEC on January 31, 2014, the passage of H.R. 2274 by the U.S. House of Representatives (422 to 0), and the current bill in the Senate Banking, Housing, and Urban Affairs Committee (S. 1923).

As our firm does not anticipate any meaningful number of Broker-Dealers electing to apply for LCFB registration, nor do we believe any firms new to the industry will be filing applications for LCFB registration, we do not anticipate a noteworthy impact.

Question 7. Proposed LCFB Rule 123 would limit the principal and representative registration categories that would be available for persons associated with an LCFB. Are there any registration categories that should be added to the rule? Are there any registration categories that are currently included in the proposed rule but that are unnecessary for persons associated with an LCFB?

It would appear appropriate to include Direct Participation Programs within the scope of the LCFB, as most of these transactions typically occur through private placements.

Question 8. Should principals and representatives that hold registration categories not included within LCFB Rule 123 be permitted to retain these registrations?

Yes, subject to the principals and representatives: (1) being associated with a LCFB firm, and (2) remaining current with the regulatory element continuing education requirements during the entire "inactive" period for non-LCFB categories of registration.

FINRA might also wish to consider instituting a prescribed inactive period (for example, 5 years) after which the principals and representatives would have to requalify for those registration categories by examination; however, this prescribed inactive period would be superseded by the current 2 year rule in the event a U-5 was filed and the registrant did not associated with another LCFB or broker-dealer.

Question 9. Does an LCFB normally make recommendations to customers to purchase or sell securities? Should an LCFB be subject to rules requiring firms to know their customers (LCFB Rule 209) and imposing suitability obligations (LCFB Rule 211) to an LCFB?

Yes. The activities listed in the proposed rule set include the words "advising an issuer" and "advising a company" – and it is clearly understood that there is almost always a fee involved when providing such services. Thus, the act of advising, be it oral or in writing, involves either an actual recommendation or some form of implicit recommendation by the person providing the advice. Our firm believes this is true irrespective of whether the advice provided is acted upon or not.

Not only do we believe K-Y-C and Suitability apply to LCFBs, we also believe AML and the FTC Red Flag Rule apply (as previously discussed in Question 1 above).

Question 10. Does the SEC staff no-action letter issued to Faith Colish, et al., dated January 31, 2014, impact the analysis of whether a firm would become an LCFB? Is it likely that some limited corporate financing firms will not register as a broker consistent with the fact pattern set forth in the no-action letter, or will they register as an LCFB?

Most firms eligible for LCFB registration are also effectively able to operate within the parameters set forth in the M&A Broker SEC No-Action Letter issued on January 31, 2014. There is no logical reason for such firms to incur the regulatory compliance obligations and associated costs when presented with a "free pass." This M&A Broker No-Action Letter gives new meaning to the old salesman's pitch, "no cost and no obligation."

Unfortunately, the SEC has disregarded investor protection in favor of a small, vocal special interest group who seeks to avoid regulatory oversight and has spent in excess of $700,000 (to date) in attorney and lobbyist fees to achieve that result.

For years, Attorney Shane Hansen has represented M&A Broker associations in their efforts to secure exemption from registration, initially with the SEC and other regulators, and now in their efforts to secure an exemption through legislation (H.R. 2274 and S. 1923).

In his written statement, testifying under oath on June 12, 2013 to the United States House of Representatives Committee on Financial Services, attorney Hansen states:

> "Accordingly, <u>a very high percentage of M&A brokers are not registered with the SEC and</u> so, technically, <u>are violating the registration requirements in federal securities laws today</u>. Their registration violations may put their clients' transactions at risk of being rescinded if the post-closing business does not run as hoped or is run into the ground by the buyer. Registration violations put the M&A brokers at risk for regulatory enforcement and sanctions, as well as their livelihood ..."

If these business broker associations are unsuccessful in their efforts to effect legislation sympathetic to their cause, the vast majority of their membership will unswervingly <u>continue to ignore and violate securities laws</u> in their ordinary course of conducting business – just as they have since 1985. It is simply unconscionable to allow this group to continue to violate securities laws to the potential detriment of investors involved in M&A Broker transactions.

In 1985, the U.S. Supreme Court ruled in *Landreth Timber Co. v. Landreth*, and a companion case *Gould v. Reufenacht*, that transactions involving the sale of closely-held company stock are "securities" within the meaning of the Securities Act of 1933, and require compliance with Section 15(a) of the Exchange Act (if applicable).

When was the SEC Division of Trading and Markets granted the authority to enact No-Action Letters in potential contraversion to, and/or without deference to, US Supreme Court decisions? I personally believe this is a dangerous path to traverse. I can only assume this has occurred under the guise of "assisting the Commission in establishing rules and issuing interpretations on matters affecting the operation of the securities markets." Second guessing the U.S. Supreme Court and creating an exception inconsistent with its repetitive, consistent decisions may very well border on unbridled arrogance. What prospective benefit is so overwhelmingly that it would justify such actions?

I urge FINRA, in the strongest possible way – encourage the SEC to reconsider the direction it is taking on this matter and the conflicting message it is sending to licensed M&A Brokers, unlicensed M&A Brokers, private equity groups, institutional investors, and individual investors.

We should not be surprised to see a flood of business cards with the title "Investment Banker" on them, including attorneys and CPAs who now believe the May 17, 2010, SEC **Denial of No-Action Request** has been superseded. This denial was issued with regard to a letter submitted by the law offices of Brumberg, Mackey & Wall, P.L.C. ("BMW").

The SEC cited several reasons for the denial, but one of them was:

> "Moreover, the Staff believes that that receipt of compensation directly tied to successful investments in ... securities by investors introduced ... by BMW [the law firm] would give BMW a "salesman's stake" in the proposed transactions and would create heightened incentive for BMW to engage in sales efforts. Accordingly, the Staff believes that your proposed activities would require broker-dealer registration."

M&A transactional attorneys typically utilize either hourly billing for the services rendered, or one of three types of alternative fee arrangements: (1) a fixed fee, (2) a fixed fee with a collar, or (3) a "broken deal"/success fee. Until the M&A No-Action letter was issued, securities laws preclude lawyers and CPAs from receiving contingent compensation as a percentage of the total price of a successfully completed transaction. Now that has changed. Does the SEC no longer believe there is a "salesman's stake" involved ... or does that just not matter any longer?

WHAT IS THE SCOPE OF THIS PROBLEM ... HOW MANY WILL BE AFFECTED?

Consider the published statistics:

1. The SBA indicates:
   a. There are **23 million** small businesses in America that account for **54% of all U.S. sales,**
   b. Small businesses provide **55% of all jobs**, and
   c. The number of small businesses in the U.S. has increased 49% since 1982.

2. Best estimates indicate there are approximately **8.1 million established businesses in the U.S**. Factoring in companies with multiple owners, there are approximately **10.2 million owners**.
   a. Established businesses are defined to be companies in business for at least 3 years and having a work location outside the owner's home, and

b. Well established small to mid-size private businesses have annual sales ranging from about $1 million to $75 million.

3. PriceWaterhouseCoopers study determined:
   a. **1 out of every 2** company owners plan to sell their business within the next 10 years, and
   b. People 55 or older own 30 % of all businesses with employees.

4. PriceWaterhouseCoopers Trendsetter Barometer Survey of Business Owners found:
   a. **51%** of business owners were planning to sell their companies to third-party purchasers, and
   b. **14%** of business owners were planning on selling to their employees.

5. Conservative estimates forecast the number of Baby-Boomer owned businesses that will be put on the market for sale in the **next 5 to 10 years will be between 1.36 and 2 million firms, and 2.5 to 3.8 million firms over the next 20 years**.

6. It is estimated that these transaction will result in the transfer of **$10 Trillion** of wealth.

7. Industry estimates indicate **80%** of a small to mid-size business owner's total net worth is attributed to their business.

How is it that this substantial number of individual investors (comprising this group of sellers) – and a like number of buyers – are not deemed to be deserving of regulatory oversight and protection? Especially when these **senior citizen** sellers are counting on the proceeds from these sales, which for most of them represents a once-in-a-lifetime liquidity event, to fund their retirement.

I personally find this surprising, and very disturbing ...

Is it reasonable, rational or prudent to believe the M&A Broker transaction marketplace can properly police itself? Our firm does not believe so.

Thank you for considering our firms comments, and please contact us if have any questions or require clarification regarding any of our remarks.

Sincerely,

RELIANCE WORLDWIDE INVESTMENTS, LLC

Ken Sweet

Kenneth Sweet
Managing Member, Principal