May 21, 2014

Via email to: pubcom@finra.org

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

Re: FINRA Regulatory Notice 14-09
Request for Comment on Proposed Rules for Limited Corporate Financing Brokers

This comment letter is submitted on behalf of the Committee on Federal Regulation of Securities (the "*Committee*" or "*we*") of the Business Law Section (the "*Section*") of the American Bar Association (the "*ABA*"), in response to the request for comment by the Financial Industry Regulatory Authority, Inc. ("*FINRA*"), in Regulatory Notice 14-09 ("*RN 14*-09" or the "*Proposal*") with respect to a proposed new rule set for "Limited Corporate Financing Brokers" ("*LCFBs*" and "*LCFB Rules*"). As described in the Proposal, an LCFB would fall within a new FINRA member firm category and engage only in a limited range of activities, essentially advising companies and private equity funds on capital raising and corporate restructuring. The LCFB Rules would not apply to member firms that carry or maintain customer accounts, handle customers' funds or securities, accept customers' trading orders, or engage in proprietary trading or market-making.

This letter was prepared by members of the Committee's Subcommittee on Trading and Markets. While this letter represents the views of those who have prepared and reviewed it, this letter has not been approved by the ABA's House of Delegates or Board of Governors and, accordingly, does not represent the official position of either the ABA or the Section.

We commend FINRA for developing a customized rule set pertinent to the limited activities of members engaged in the subset of activities described in the Proposal. We strongly encourage FINRA to move forward with refining and advancing the Proposal to the formal rulemaking stage after taking into consideration the various comments and recommendations you receive during this initial public comment process. As set forth in detail below, we have responded to FINRA's request for comments on RN 14-09 and also provide our views about the strong public policy rationale underlying the Proposal and other rulemaking in conjunction with FINRA's retrospective rule review.[1]

[1] *See, e.g.*, FINRA Regulatory Notice 14-14, *FINRA Requests Comment on the Effectiveness and Efficiency of its Communications With the Public Rules;* FINRA Regulatory Notice 14-15, *FINRA Requests Comment on the Effectiveness and Efficiency of its Gifts and Gratuities and Non-Cash Compensation Rules.*

General Comments

FINRA requested comment on all aspects of the LCFB Rules, including any impact on institutional customers and issuers, potential costs and burdens that the Proposal could impose on LCFBs, and any cost savings and reduced burdens that the proposal would create for LCFBs. FINRA also requested comment on whether LCFBs should be subject to other requirements in the transitional and consolidated FINRA rulebook (together, the "*FINRA Rules*"). Set forth below are our general comments regarding the Proposal as well as other observations regarding FINRA's rulemaking process, followed by our more specific comments with respect to the proposed LCFB Rules.

As a general matter, we believe FINRA should give careful consideration to the impact of the LCFB Rules, as well as existing rules, on smaller, limited, and non-traditional firms including "finders", merger and acquisition intermediaries, advisers, and business brokers (collectively, "*M&A brokers*"), and private fund placement agents. These types of members would, in our view, be the most likely to benefit from and utilize the relief created by the Proposal. Accordingly, our comments are primarily focused on the LCFB Rules as relevant to these members. We also believe FINRA should take into consideration the potential impact of the Proposal—and, as importantly, the failure to move forward with it—upon the availability of capital-raising and business brokerage services to smaller privately held companies and private funds. These types of customers are most often served by smaller, limited, and non-traditional members.

Particularly in the context of the LCFB Rules and ideally in all of the FINRA Rules, we believe FINRA should more clearly differentiate between capital-raising and M&A brokerage services, which are two very different types of securities-related activities and are accompanied by correspondingly different "investor protection" considerations. We also believe the FINRA Rules need to better accommodate limited brokerage service business models, such as members that place private fund securities with "institutional investors", as we suggest that term be redefined. There are important contextual distinctions between private and public companies, private and public offerings, active versus passive investors, and sophisticated institutional investors staffed by professional managers, yet the FINRA Rules largely combine these securities-related activities together making it challenging for member firms to parse these rules for those requirements applicable to their particular activities.

With these considerations in mind, we believe several of the proposed LCFB simplifications do not go far enough to be meaningful to either smaller FINRA member firms or the smaller business issuers and owners intended to be served by the Proposal. We also believe FINRA should give greater consideration to the overall complexity and largely retail brokerage orientation of the FINRA Rules in general. As reported in its 2012 Year in Review and Annual Financial Report, FINRA has embarked upon a more structured analysis of the costs and benefits of new and existing rules. We commend those efforts, particularly since the economic impact of the FINRA Rules on smaller member firms and the smaller privately owned companies they commonly serve have not, in the view of many industry participants, been given adequate consideration. Smaller firms and the smaller business issuers they serve often do not have the awareness of rulemaking proceedings, the financial or managerial resources to devote, or the regulatory expertise to submit comment letters on FINRA's rulemaking proposals. The Securities and Exchange Commission (the "*SEC*") is by law subject to rigorous economic and competitive analytical requirements in its rulemaking. Since Congress and the SEC have delegated substantial regulatory authority to FINRA (and since FINRA membership is effectively mandated for nearly all SEC-registered broker-dealers[2]), the same standards for economic and competitive analysis should be applied to FINRA's rulemaking and should be evaluated by the SEC as if it were its own when acting on those rulemaking proposals.

This Proposal, together with FINRA's retrospective rule review, are critically important to the securities industry, institutional investors and, as importantly, other stakeholders, including (1) privately held companies seeking to raise capital to start, grow, acquire, or sell businesses; (2) owners of privately held companies seeking to sell, and prospective buyers seeking to buy, smaller businesses; and ultimately (3) employees who depend on those privately owned businesses for their livelihoods. Similarly, venture capital and private equity funds, business development companies, and similar privately-raised pools of capital are critically important financial resources for privately held companies at various stages of their development. These types of professionally-staffed institutional investors are well-equipped to do their own due diligence, economic and financial analysis, and evaluation of privately owned businesses and thereby to more effectively provide corporate financing or acquire a controlling interest in a portfolio company. Participation in these transactions by well-managed pooled investment vehicles reduce some of the risks associated with small business enterprises for the benefit of their own investors through diversification of their portfolios of corporate financings and acquisitions, and so as a matter of public policy should be strongly encouraged.

FINRA's regulation of securities-related services has a direct and substantial impact on each of these stakeholders whose interests are often not well articulated in the context of broker-dealer regulation or rulemaking. Addressing several areas of particular concern will require FINRA's coordination with the SEC and a joint evaluation of how their respective rules impact the securities-related services available to smaller private business issuers and owners. These stakeholders depend on and benefit from the professional services provided by intermediaries that are, or by law should be, registered and regulated as broker-dealers under Section 15 of the Securities Exchange Act of 1934, as amended ("Exchange Act"), and related rules. The statutory definition of "broker" and related interpretations and guidance issued by the SEC and its staff[3] encompass a broad range of securities-related activities subsumed within the traditional

[2] *See* Section 15(b)(8) under the Securities Exchange Act of 1934, as amended, which provides: "It shall be unlawful for any registered broker or dealer to effect any transaction in, or induce or attempt to induce the purchase or sale of, any security (other than commercial paper, bankers' acceptances, or commercial bills), unless such broker or dealer is a member of a securities association registered pursuant to section 15A of this title or effects transactions in securities solely on a national securities exchange of which it is a member." FINRA is the only registered securities association at present.

[3] *See* Exchange Act Section 3(a)(4). *See also* SEC Staff *Guide to Broker-Dealer Registration*, available at: http://www.sec.gov/divisions/marketreg/bdguide.htm; SEC staff no-action letters cited in the American Bar As-

bundles of services characterized as an "investment banking or securities business" as that phrase is used throughout FINRA's By-Laws and the FINRA Rules.[4] Yet these stakeholders do not necessarily want, nor can they afford, the services offered by traditional full-service broker-dealers.

Understandably, FINRA's By-Laws and the FINRA Rules have been written and have evolved largely based on the paradigm of a member being engaged in investment banking or securities business because, historically, the majority of FINRA members were engaged in either or both of these types of activities. When FINRA was first organized, its membership was voluntary and was likely far more homogeneous than the demographics of its membership today. The resulting "one-size fits all" system of regulation with its related complexity of compliance requirements and associated costs may inhibit—or even preclude—providing more limited and more affordable securities-related services needed by smaller privately held companies and their owners. As a result, those services may be either provided unlawfully by unregistered persons or not provided at all.

For example, smaller privately held companies may seek capital from a small number of investors and only seek initial introductions to those prospects. Similarly, some larger privately held companies may seek institutional corporate financing through a negotiated transaction that involves its issuance of custom-tailored securities to a single professional investor, such as a private fund or insurance company. Commonly in these instances, the broker does not handle, even momentarily, the issuer's securities or the investor's cash and so no custody-related investor protection, SIPC, or anti-money laundering considerations appear to be implicated. Typically, in these transactions the broker has not undertaken any financial obligation to the issuer or investor and yet a panoply of net capital and operational rules still apply, including those requiring GAAP accounting, quarterly financial reporting, audited financial statements, employment of a financial and operations principal, and anti-money laundering procedures. Each of these requirements imposes a substantial on-going compliance cost, but without any apparent investor protection benefit given this limited service context.

Similarly, the owners of smaller private companies eventually need assistance in preparing for sale, finding buyers, and transitioning ownership. Small business sales are commonly structured as cash-for-assets transactions and do not involve securities or related regulation; however, for various reasons, in some transactions the parties may choose to convey ownership through the transfer of the company's securities—a stock sale or exchange through a merger or other business combination. The same economic objective of the parties—conveying ownership of the business—can have vastly different regulatory consequences to the M&A broker de-

sociation, Business Law Section, *Report and Recommendations of the Private Placement Broker-Dealer Task Force* (2005), available on the SEC's web site at http://sec.gov/info/smallbus/2009gbforum/abareport062005.pdf ("*ABA PPB Report*").

4 FINRA By-Laws, Article I, paragraph (u) defines the phrase "investment banking or securities business" as "the business, carried on by a broker, dealer, or municipal securities dealer (other than a bank or department or division of a bank), or government securities broker or dealer, of *underwriting or distributing issues of securities, or of purchasing securities and offering the same for sale as a dealer, or of purchasing and selling securities upon the order and for the account of others*" (emphasis added).

pending on the parties' choice of transaction structure. Even if a member's securities-related activities are limited to making introductions of investors to issuers or brokering the sale of business, under existing rules the member must maintain substantially all of the compliance infrastructure required of a member firm offering the full range of brokerage services.[5]

The organization and sheer complexity of the FINRA Rules is a concern. For example, "investment banking" is a term used in FINRA's By-Laws and the FINRA Rules, but it is not defined as a stand-alone activity for purposes of general applicability in the FINRA rulebook.[6] Most references to this term in the FINRA rulebook occur where the phrase "investment banking or securities business" is used conjunctively, thus underscoring the particular provision's application to both sets of activities. Other provisions are simply silent, and so presumed to apply to both sets of activities, yet do not necessarily appear to be relevant to both activities as noted below. In only a few of those instances does the term "investment banking" stand on its own in application to a subset of regulated activities.[7] As a consequence, every member regardless of size, scope of activities, or resources must fully comprehend, monitor for changes, and apply FINRA's By-Laws and virtually all of the FINRA Rules to their "investment banking or securities business".

Analyzing how the FINRA Rules do and do not apply in a limited, non-traditional context is sometimes difficult, even for experienced securities counsel. Existing rules, perhaps for historical reasons that are no longer applicable, do not appear to distinguish between capital-raising where protecting passive investors is a paramount consideration, and M&A transactions where sellers and buyers of privately owned companies control and actively run those businesses and where buyers perform substantial self-directed pre-purchase due diligence because they will control and run the business after closing. FINRA's "know your customer" and "suitability" rules as applied to "customers" who are passive investors make little sense when applied to business sales and M&A transactions.[8] How does a member demonstrate the customer-specific suitability of an M&A transaction to a prospective business seller or buyer?[9] Many small business

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5 This assumes that the intermediary is, in fact, SEC-registered and not relying on SEC staff no-action letters to avoid broker-dealer registration. The limitations and impact of these no-action letters is discussed later in this letter.

6 The term "investment banking services" is defined is FINRA Rule 2711, *Research Analysts and Research Reports*, but only for purposes of that specific rule. FINRA Rule 2711(a)(3) provides "[i]nvestment banking services" include, without limitation, acting as an underwriter or participating in a selling group in an offering for the issuer; acting as a financial adviser in a merger or acquisition; providing venture capital, equity lines of credit, private investment, public equity transactions (PIPEs) or similar investments; or serving as placement agent for the issuer."

7 *See, e.g.,* NASD Rule 1032(i)(defining the registration and qualifications category of "Limited Representative—Investment Banking"); FINRA Rule 2711, *Research Analysts and Research Reports*; and FINRA Rule 5110, *Corporate Financing Rule—Underwriting Terms and Arrangements*.

8 *See* FINRA Rule 2090, *Know Your Customer*, and FINRA Rule 2111, *Suitability*; *see also* subsection (b)(4) of FINRA Rule 0160, *Definitions* and SEC Rule 15c1-1, *Definitions*.

9 *See, e.g.,* Regulatory Notice 10-22, *Obligation of Broker-Dealers to Conduct Reasonable Investigations in Regulation D Offerings*.

buyers do not meet FINRA's definition of an "institutional account".[10] Does that terminology and definition truly make sense in an M&A context? Does a member really have an "account" relationship with a business seller, buyer, or prospect? Is a business seller or buyer's investment objectives or tax status relevant to an M&A transaction? Customary contractual obligations owed by a broker-dealer to its client in an M&A engagement may be inconsistent with the regulatory notion that the counterparty to the transaction is also a "customer" of the broker-dealer.[11] Must a member deliver a "confirmation" to a business buyer prior to the closing of an M&A transaction?[12] The FINRA Rules, including the proposed LCFB Rules, should be reviewed and reconsidered in light of current day realities, technological advances and expansion of securities-related markets and participants in order to more clearly state their particular scope and application (or not) to various types of securities transactions and activities.

The complexity and compliance costs associated with obtaining and maintaining registered status for limited purpose members are prohibitive for small firms with limited purpose business models. Increasing regulatory complexity and higher compliance-related costs are among the reasons frequently cited by members in closing their doors. The tangible impact of this trend is evidenced by the dramatic decrease in FINRA's membership over the last decade, further increasing the proportionate share of regulatory infrastructure costs borne by the remaining member firms, and likely contributing to FINRA's annual operating deficits.[13] As a result, the adverse economic impact on small members and the smaller companies and business owners they serve has grown progressively worse over the years.

For example, the burdens and costs of initial broker-dealer registration and on-going compliance with current SEC and FINRA requirements are quite substantial. In our experience, initial legal, accounting, and compliance-related costs for even the most basic broker-dealers often exceed $150,000 and on-going compliance-related costs can easily be in the range of $75,000 to $100,000 per year. Applying for and obtaining FINRA membership takes a minimum of six months (without taking into consideration the time necessary to ready the initial application for submission) and is frequently longer for non-traditional applicants despite the limited or narrow focus of their proposed activities. The application process is confusing to applicants where the proposed activities do not fit the traditional "investment banking or securities business" paradigms. Commonly during the application process, FINRA requires new applicants to have written supervisory procedures to address a variety of securities-related activities they do not intend to perform under their submitted business plan. Form BD nowhere identifies "investment banking", M&A, business brokerage, or similar concepts as a type of regulated "stand-

10 Subsection (c) of FINRA Rule 4512, *Customer Account Information*.

11 Consider, for example, that many state real estate licensing laws do not contemplate a dual agency relationship and may, in fact, prohibit a real estate broker from representing both the seller and the buyer in a contemplated sale of property. Commonly both securities and real estate licensing apply to the broker in an M&A transaction.

12 *See* SEC Rule 10b-10 and FINRA Rule 2232, *Customer Confirmations*.

13 See FINRA's "year in review and annual financial reports", available at: http://www.finra.org/AboutFINRA/AnnualReports.

alone" activity in the laundry list of Item 12 activities or the Form's instructions. Accrual-based GAAP accounting, quarterly financial reporting, annual audits, a financial and operations principal, anti-money laundering programs,[14] periodic independent third-party AML testing, and SIPC-related compliance and fee assessments are required for all members—even those who never have custody or possession of "customer funds or securities" and thus no apparent investor protection objective is served. We recognize that these particular requirements are largely driven by SEC rules and we strongly encourage FINRA to cooperatively work with the SEC to refine these requirements in the context of this Proposal and other rulemaking efforts that may follow.

Because of these requirements, smaller member firms cannot profitably or cost-effectively provide a limited subset of securities-related services to smaller privately held companies. Their resources are necessarily economically structured to serve larger companies in larger transactions. Smaller companies and their owners cannot afford these professional services, particularly in view of the relatively small size of their desired capital-raise, business sale, or M&A transaction. The net result is that the aforementioned stakeholders are unable to obtain limited, more affordable securities-related services. Without access to cost-effective services, smaller privately owned businesses are unable to start, grow, and thereby preserve or create jobs that are critical to our national economy.

Helpfully, the LCFB Rules would allow for some simplification and customization of the requirements, but there are still a number of areas in which the proposed rules could be further streamlined and relaxed in order to enhance the regime's utility without sacrificing important investor protections. Accordingly, we strongly encourage FINRA to re-examine the proposed LCFB Rules and all of its existing rules with these considerations in mind.

We also encourage FINRA to work closely with the SEC to review and streamline the financial and operational rules applicable to limited-service broker-dealers, such as LCFBs, and with the North American Securities Administrators Association and state securities regulators, to discuss the rationale underlying the LCFB Rules and to coordinate regulatory reform efforts, so as to reduce regulatory inconsistencies and enhance uniformity at the federal and state levels.

Specific Comments

FINRA requested comment concerning certain specific issues. For convenience of reference, each of those issues is repeated below followed by our comments.

[14] Title 31, Part 1023, *Rules for Brokers or Dealers in Securities*, under the Bank Secrecy Act, defines the operative terms "customer" and "account" for purposes of the Customer Identification Program required under Section 1023.220. Section 1023.100(d) provides, in relevant part, that a "customer" is "a person that opens a new account". Subparagraph (a)(1) provides that an "account" is "a formal relationship with a broker-dealer established to effect transactions in securities, including, but not limited to, the purchase or sale of securities and securities loaned and borrowed activity, and to hold securities or other assets for safekeeping or as collateral." Many, if not most, LCFBs would not have an "account" relationship with customers as so defined.

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

We believe the LCFB Rules provide sufficient protections to customers of LCFBs because the rules are tailored to the business model, risks and constituencies of these firms, as well as to the nature of the relationship and interaction between the LCFB and such customers (or, perhaps more precisely, "counterparties"). Relaxed regulatory requirements in the LCFB context are mitigated by the sophistication and active involvement of the parties to these types of transactions, who are assisted by their own internal and external financial advisers and legal counsel throughout the process.

Institutional corporate financing and M&A transactions, to the best of our knowledge, have not historically been the subject of frauds or abuses. Based on the notable absence of reported disciplinary actions, we believe FINRA has not observed significant regulatory concerns with members operating in these limited contexts. Commonly, participants in these types of transactions are represented by counsel and rely on their negotiated civil remedies if post-closing disputes arise.

We have not identified material gaps to investor protection that would be created by the Proposal. Public and investor (including sellers and buyers of businesses) understanding could be modestly enhanced by requiring delivery of a simple form of disclosure describing the limited scope of securities-related services permitted under the LCFB classification.

With respect to the LCFB Rule 200 Series, *Duties and Conflicts*, we support the more streamlined approach that keys the duties to the actual conflicts and risks of LCFBs. With respect to the LCFB Rule 300 Series, *Supervision and Responsibilities Related to Associated Persons*, we support giving member firms flexibility to tailor their supervisory systems to their business models. This is consistent with the FINRA Rules, as well as the Exchange Act.

With respect to the LCFB Rule 400 Series, *Financial and Operational Rules*, we believe FINRA should work closely with the SEC to modify these existing rules. For example, LCFBs are not permitted to have custody or possession of the parties' funds or securities. The parties typically close these transactions themselves and the purchase price is typically wired between the parties' commercial banks, which are already subject to AML rules and requirements. Typically, LCFBs do not have material financial obligations to their issuer/seller or investor/buyer clients. Accordingly, we see little or no investor protection benefit to require accrual-based accounting under GAAP, periodic financial reporting, audited financial statements, a financial and operations principal qualified under the Series 27 or 28 exams, anti-money laundering programs with periodic third-party testing, or SIPC requirements. These are inherently expensive on-going compliance requirements for which no apparent investor protection benefit is obtained in this context.

With respect to LCFB Rules 1000, et seq., *Arbitration and Mediation*, we simply observe that it is unusual for members to include mandatory binding arbitration agreements in their M&A engagements.

With respect to M&A transactions, we note that the SEC staff's issuance of the "M&A Broker" no-action letter dated January 31, 2014 (the "*M&A Broker Letter*"),[15] implicitly acknowledges that, all things considered, the imposition of SEC broker-dealer registration, FINRA membership, and the associated regulation are unwarranted in the context of qualifying M&A transactions involving privately held companies. However, as discussed below, members may choose not to rely on the M&A Broker Letter for various reasons, so the FINRA Rules as applied in this context could be further relaxed, thereby leveling the playing field and associated regulatory costs among members and their unregistered competitors.

- *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?*

As explained in our general comments, we believe the FINRA Rules, and particularly the proposed LCFB Rules, should take into greater consideration the comparatively heavier burdens and adverse competitive impacts on smaller member firms handling transactions for smaller privately held companies and owners, as well as other limited non-traditional firms such as those assisting private funds with fund-specific capital-raising activities. These are materially different contexts than SEC-registered offerings involving public companies with retail investors. The elimination or modified application of certain investor protection-based requirements in institutional corporate financing and M&A transactions is typically balanced by, among other things, the sophistication of the parties and their active participation in the negotiation of specific terms, conditions, and contractual remedies; direct access to the issuer's management team and corporate information; and competent internal staffing and third-party advisors to perform their own thorough self-directed due diligence on the issuer/seller.

Moreover, we strongly believe that, to be useful to capital-raising by smaller privately held businesses, placement agents to private funds and others, an investor threshold lower than FINRA's "institutional account" definition must be used. In view of the typical capital needs of smaller private issuers, and private funds relying on the "3(c)(7)" exemption from registration under the Investment Company Act of 1940, as amended (the "*1940 Act*"), we recommend using a "qualified purchaser" standard as defined in Section 2(a)(51)(A) of the 1940 Act,[16]

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[15] 2014 SEC No-Act. LEXIS 92 (2014).

[16] As defined in Section 2(a)(51)(A), a "qualified purchaser" means "(i) any natural person (including any person who holds a joint, community property, or other similar shared ownership interest in an issuer that is excepted under section 3(c)(7) with that person's qualified purchaser spouse) who owns not less than $5,000,000 in investments, as defined by the Commission; (ii) any company that owns not less than $5,000,000 in investments and that is owned directly or indirectly by or for 2 or more natural persons who are related as siblings or spouse (including former spouses), or direct lineal descendants by birth or adoption, spouses of such persons, the estates of such persons, or foundations, charitable organizations, or trusts established by or for the benefit of such per-

together with the other categories of investors listed in Rule 5123(b)(1) for purposes of the exemption from the filing requirements imposed under that rule. We believe these types of investors are generally capable of evaluating the relevant risks associated with the types of transactions covered by the LCFB Rules, and so we see no reason why FINRA should adopt a stricter standard for purposes of the LCFB regime than was deemed sufficient by it to achieve the investor protection goals of FINRA Rule 5123 (which was adopted following SEC approval in 2012).

We encourage FINRA to develop examination modules, document requests, and examiner training geared to the LCFB Rules (assuming the proposed regime's eventual adoption). By using a more customized approach, we believe the examination process could be more effective and efficient for examiners and members. FINRA has developed excellent instructional materials for members and delivers that content through a variety of convenient mediums. New instructional materials tailored to the LCFB audience should be developed.

- *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?*

We believe the proposed functional definition is too narrow because there are related activities commonly performed that should also be permissible and, without which, the public policy rationale behind the Proposal would not be achieved. Notably, the presently listed permissible activities appear to allow only communications with the issuer or business seller, or at most "offers" but no involvement with negotiations or "sales" of securities to qualifying investors/buyers. As proposed in RN 14-09 (emphasis added):

> The term "limited corporate financing broker" would include any broker that *solely* engages in one or more of the following activities:
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> - *advising* an issuer, including a private fund, concerning its securities offerings or other capital raising activities;
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> - *advising* a company regarding its purchase or sale of a business or assets or regarding its corporate restructuring, including a going-private transaction, divestiture or merger;
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> - *advising* a company regarding its selection of an investment banker;

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sons; (iii) any trust that is not covered by clause (ii) and that was not formed for the specific purpose of acquiring the securities offered, as to which the trustee or other person authorized to make decisions with respect to the trust, and each settlor or other person who has contributed assets to the trust, is a person described in clause (i), (ii), or (iv); or (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, not less than $25,000,000 in investments." *See also* related SEC Rules 2a51-1, 2a51-2, and 2a51-3.

- *assisting* in the preparation of offering materials on behalf of an issuer;
- *providing* fairness opinions; and
- *qualifying, identifying or soliciting* potential institutional investors.

We note that all of the listed activities except the last envision limiting the LCFB's communications to those with the issuer or business seller, with the last apparently being limited to solicitations. In our view, these limitations are unworkable in the context of (i) institutional corporate financing; (ii) M&A transactions; and (iii) limited purpose members such as private fund placement agents.

With respect to both institutional corporate financing and private fund placement agents, the LCFB classification would be virtually useless unless the member is also permitted to communicate with prospective investors in a manner that is not confined to "solicitation" activity. In particular, in the institutional corporate financing context, the framework would have very little utility if LCFBs are unable to be actively involved in the discussions, negotiations, and structuring of the contemplated corporate financing transaction. For private fund placement agents, we believe that the LCFB definition should encompass communications with qualified investors and the full range of related activities, including the secondary placement of private fund interests pursuant to Rule 144A under the Securities Act of 1933, as amended.

Similarly, in the M&A context, we believe that LCFBs must be permitted to communicate with and become involved in all aspects of these transactions.[17] Commonly, M&A transactions involve the resale or exchange of outstanding securities, so LCFBs must also be able to communicate with a company's shareholders. A prospective investor or a business buyer may engage an M&A broker to find, screen, evaluate, and approach prospective companies/issuers/sellers. So-called "buy-side" engagements do not appear to come within the scope of permitted activities, but are quite common in the M&A context.

We encourage FINRA to incorporate into the LCFB definition activity-related concepts used in the definition of "M&A broker" in the M&A Broker Letter. In addition, the definition needs to be refined to state clearly that the "institutional investor" requirement does not apply to M&A-related activities, as explained in endnote 3 to RN 14-09. We concur that there is no need to apply any "institutional investor" qualification to M&A transactions where both the seller and buyer are or will control and be actively involved in running the business. Moreover, to do otherwise would, in effect, preclude smaller business sellers and buyers who are not "institutional investors", as presently defined by FINRA, from obtaining these professional services. For example, in a management buy-out and in the formation of an employee stock ownership plan ("ESOP"), the business buyers are typically not "institutional investors". This approach is also consistent with the M&A Broker Letter, which imposes no such conditions.

[17] *See, e.g.,* the scope and description of M&A broker activities provided to the SEC staff in the incoming submission that resulted in the issuance of the M&A Broker Letter.

- *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?*

As presently proposed, we believe the permissible scope of activities is too narrow, and the institutional investor threshold too high, for any member to find the LCFB regime to be a commercially or economically attractive alternative. As noted above, additional reforms in the financial and operational rules (which would require coordination with the SEC staff) could result in substantially greater cost savings without diminishing investor protections in the context covered by the LCFB Rules. Current members have already obtained full membership and created the compliance infrastructure necessary to maintain it, so would have relatively little incentive to substantially narrow the scope of their presently permitted activities in exchange for its limited benefits.

We believe many prospective members will still find the new membership application process to be daunting, frustrating, costly, and time-consuming. As a way to measure and address these concerns now and over time, we encourage FINRA to periodically conduct anonymous surveys of new members who have recently completed the process, including questions identifying the types of approved member activities.

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

Unless the additional reforms we have described are adopted, the likely economic impact to an LCFB of the adoption of the Proposal would be negligible. As described elsewhere, there are a number of opportunities for meaningful cost savings that are not presently part of the Proposal. We believe these cost savings are very important. The present impact of FINRA's "one-size-fits-all" approach on competition among broker-dealers disproportionately burdens smaller members far more than the larger firms that have the economic resources, business volume, and average transaction size over which to spread their largely fixed compliance costs. These considerations have not been adequately addressed in FINRA's historical cost/benefit and competitive analyses, which we believe need to be as robust as those required of the SEC in a rulemaking context, because of FINRA's delegated authority and legally mandated membership.

On the other hand, the M&A Broker Letter may have a far greater and immediate competitive impact by allowing unregistered firms and individuals to engage in qualifying M&A activities without any of the substantial costs and burdens of SEC registration and FINRA membership. If the LCFB Rules are adopted with the adjustments we are recommending, we believe smaller privately held businesses and their owners could be greatly benefited by the opportunity to receive these limited but more cost-effective services from members. We believe the adoption of the LCFB Rules (to the extent modified along the lines suggested herein) would help to level the competitive playing field with unregistered service providers.

Similar considerations of competitive equity are relevant to private fund placement agents. Many private fund managers are calling on the SEC staff to expand the relief provided in SEC Rule 3a4-1, *Associated Persons of an Issuer Deemed Not to Be Brokers*, from SEC broker-dealer registration (and FINRA membership). This relief would only apply to issuers, creating a serious competitive disadvantage for those members only acting as private placement agents. Placement agents that are not affiliated with any private fund perform virtually the same functions as a private fund manager's employees, but they will remain subject to the FINRA Rules, even while issuers have less need for placement agent services by instead using rapidly evolving general solicitation techniques. If adopted with the recommended modifications, the LCFB Rules would allow these members to more cost-effectively provide unaffiliated placement services.

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

While we have no statistical data upon which to base a numerical estimate, in view of the frequency of questions we receive pertaining to broker-dealer registration with respect to these limited subsets of securities-related activities, we believe there is a significant number of presently unregistered intermediaries engaged in limited capital-raising and business brokerage activities who, if presented with a straightforward, economically viable alternative, may register with the SEC and become limited FINRA members in order to have greater regulatory certainty with respect to their activities.

- *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?*

We strongly encourage FINRA to re-examine how its limited registration categories are aligned for purposes of both the FINRA Rules and the Proposal. Current classifications artificially distinguish between, and require separate examinations for, the sale of corporate stock (Series 62 and 82) and limited liability companies ("*LLCs*") and general partnerships (Series 22). Securities-related activities covered by the Series 22 classification are expressly excluded from the Series 62 and 82 classifications. This distinction was created in a day when "direct participation programs" ("*DPPs*") were a unique type of securities product because of their tax treatment and how they were marketed to retail investors. Today, LLCs are commonly used in all business contexts and are by no means limited to DPPs. Many businesses choose the LLC business structure because of its flexibility in corporate governance, as well as its optional pass-through tax treatment. The net effect of this artificial alignment of classifications is to require individuals to take and pass more examinations than we believe should be required to engage in essentially the same securities-related activities involving corporations, LLCs, or general partnerships. The Series 22 classification could be redrawn by focusing on other characteristics of a DPP "program" that are, in substance, different than a general business operated as an LLC or general partnership.

FINRA's realignment also should address the Series 82 classification's scope. Read literally, the Series 82 only covers sales "as part of a primary offering of securities", and hence does not appear to cover resales of outstanding securities as would occur in a typical M&A transaction. The Series 82 is cited by FINRA's FAQs[18] as an alternative to the Series 79, but without adjusting the scope of the Series 82 to include LLCs and general partnerships, as well as resales of outstanding securities, that alternative compliance approach would not work.

We also encourage FINRA to reassess the scope and application of its Series 79 classification. When developed and even when announced in Regulatory Notice 09-49, *Investment Banking Representative*, this classification was widely expected to serve as the single FINRA classification and examination necessary to engage in all aspects of investment banking activities. To the surprise of many, FINRA's FAQs limited its scope to advisory-only activities and included no selling-related activities. When coupled with the misalignment of the Series 62/82 and exclusion of the Series 22 classifications, noted above, FINRA's FAQs substantially added to the compliance burden placed on smaller firms and their associated persons with respect to M&A transactions for smaller companies. Parts of the Series 79 are relevant to M&A brokers, but the exam presently includes a significant component of public offering-related content that is not relevant in this context. An alternative approach could consider the adaptation of an LCFB examination from existing outlines and content.

We also believe that the Series 24 classification's exam includes a significant component of content that has little or no relevance to the operation of a limited purpose broker-dealer or the activities that would be covered by the LCFB. Instead, we believe that either of FINRA's existing Series 62 or 82 exams (modified to include LLCs and general partnership engaged in a general business and resales), together with the states' Series 63 exam, are adequate to cover the principal and representative activities contemplated by the LCFB classification in so far as they do not involve public offerings. For many reasons few, if any, smaller members or LCFBs would ever consider becoming engaged in a public offering. In contrast, we believe few, if any, larger members who regularly handle public offerings would ever consider becoming an LCFB. Public offerings generally require the commitment of substantial firm resources and are designed for the broadest universe of prospective investors; in contrast, the LCFB Rules are designed for smaller private offerings involving a limited subset of sophisticated investors and privately owned businesses.

Finally, we believe there is no investor protection purpose served by applying the Series 99, *Operations Professional*, qualification or related examination to LCFBs. While relevant in a retail brokerage context, the limited business models of LCFBs would not have the transaction volume or operational components to justify the use of this examination.

[18] Posted on FINRA's website at http://www.finra.org/Industry/Compliance/Registration/QualificationsExams/Qualifications/FAQ/P124190.

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

We believe it serves no investor protection principle to prevent securities industry professionals from retaining validly held qualifications permitting broader activities while they remain engaged in a subset of those activities. Associated persons do not lose their past training, knowledge and, as importantly, experience and, if they rejoin a fully-registered member, will resume the continuing education training pertaining to the broader activities.

- *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?*

The term "recommendation" is not expressly defined by FINRA; instead, general guidance as to what may constitute a recommendation is provided in a number of largely unrelated interpretations, as well as court opinions (usually addressing fraudulent conduct), creating no bright lines and making the legal analysis of the particular facts and circumstances challenging.[19] Often, out of an abundance of caution there is a tendency to treat every discussion regarding a securities transaction with a potential counterparty that is not itself a broker or dealer as a "recommendation" to a "customer". As discussed above, the LCFB classification would have little to no utility if it did not include the ability to communicate with prospective investors/buyers, and for buy-side M&A engagements, to communicate with prospective sellers. Such communications with a prospective investor/buyer/seller specific to a capital-raising offering or M&A transaction could be construed, perhaps over-broadly, as a "recommendation".

For this and the reasons noted in our general comments, we strongly encourage FINRA to more clearly define a "recommendation" and reconsider its definition of "customer" in the LCFB context, as reflected in LCFB Rule 209. Given the limited scope of LCFB activities, there is no traditional customer relationship and no "account" to service and, accordingly, we do not believe that communications by LCFBs with these types of investors and in the context of the limited transactions covered by the LCFB regime should constitute a "recommendation".

With respect to LCFB Rule 211, reference to or the use of a "customer profile" or an "investment strategy" would not be relevant. The prescribed content of such a "customer profile" is incongruent with the predicate for the LCFB Rules, particularly with respect to M&A transactions. Similarly, the prescribed customer information required by LCFB Rule 451(b) should be modified to reflect the types of parties who would be served by LCFBs. We believe the same would be true for other limited purpose, non-traditional members such as private fund placement agents.

[19] *See* FINRA Rule 2111; *see also* FINRA's "Frequently Asked Questions: FINRA Rule 2111 (Suitability)" and FINRA Regulatory Notices 12-55, 12-25 and 11-25.

Similarly, the "know your customer" and customer suitability obligations are of far less relevance in the context of institutional corporate financing activities and private fund placement activities, and wholly irrelevant to M&A transactions. Potential investors in "3(c)(7)" funds are, by virtue of the exemption's conditions,[20] limited to qualified purchasers. Subscription agreements and purchaser questionnaires typically include, among other things, representations and warranties attesting to the conditions defining a qualified purchaser.

Institutional corporate financing and M&A transactions are commonly heavily negotiated. Unlike a small retail investor, institutional investors and high net worth individuals have sufficient economic bargaining power to exert substantial influence over, if not dictate, the terms and conditions they will either offer to or accept from the issuer. In this context, there is no doubt that the investor/buyer is exercising independent judgment and fully self-evaluating investment risks. Accordingly, in the LCFB context there is little investor protection purpose served by these rules. Further, in the M&A context, the prospective business buyer will do its own self-directed pre-purchase due diligence, will assess whether the target business comes within its strategic, financial, or business objectives, strategies, and plans, will determine the price and terms it is willing to offer, and will control the business after the transaction's closing.

We recommend that LCFB Rule 221 recognize that in the LCFB context an introductory communication, summary in nature, is typically produced, which is initially distributed to prospective institutional investors or business buyers and used to determine if they have any interest in a potential transaction. As written, LCFB Rule 221 says "no" communication may "omit any material fact or qualification". Inherently, by design, these summary documents do not contain all material facts and circumstances that may pertain to the issuer/seller. Prospective institutional investors and business buyers want a condensed summary to determine, as an initial matter, whether they wish to devote any additional time or resources to considering whether a potential transaction is of any interest. Typically, these summary documents are expressly qualified in their entirety by the extensive information and documentation that will be directly accessible, subject to a confidentiality agreement, by each prospective institutional investor/buyer as an integral part of its self-directed pre-purchase due diligence. Direct access is provided to the issuer/seller's management team and commonly electronic access to material documents as identified by the issuer/seller and its counsel.

In the M&A context, it is also common for the seller's written materials to include forward-looking information about such matters as projected sales growth, including opening new markets and developing new products. This type of forward-looking information is self-evaluated by the prospective business buyer as part of its due diligence process. LCFB Rule 221 should not prohibit this type of information from being provided where the prospective institutional investor or business buyer is capable of self-evaluating this type of forward-looking information.

[20] *See* Sections 2(a)(51)(A) and 3(c)(7) of the 1940 Act, and SEC Rules 2a51-1, 2a51-2, and 2a51-3.

- *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?*

We believe it is likely that some, but not all, LCFB-eligible persons will choose not to become SEC-registered broker-dealers and, consequently, FINRA members. The M&A Broker Letter and similar prior SEC staff no-action letters provide the Staff's view as to the circumstances in which broker-dealer registration should not be required.[21] However, these no-action letters have significant limitations, both as a legal and practical matter.[22] Importantly, the M&A Broker Letter does not allow for general capital-raising activities where no change of control occurs. Hence some members are certain to remain registered (and new applicants may apply for FINRA membership) in order to engage in both types of securities-related activities. The FINRA Rules should recognize and give appropriate effect to the reality that members' M&A-related services within the scope of the no-action relief compete with large numbers of unregistered M&A brokers who rely on the SEC staff no-action letters. Adopting the LCFB Rules, with our proposed modifications, would help to balance the competitive circumstances as between registered and unregistered M&A brokers.

We also believe that some members could choose to bifurcate their business model by moving those activities falling within the scope of the M&A Broker Letter into an unregistered affiliate. Most firms will have dually employed associated persons and so NASD Rule 3040, as currently in effect, will likely require the registered member to supervise the private securities transactions conducted through the unregistered affiliate.[23] The unregistered affiliate could pay its affiliated member for the cost associated with its supervision, but the transaction-related revenue is not required to be paid to the member under this rule. Accordingly, members

[21] *See, e.g., M&A Broker Letter*; *Country Business, Inc.*, 2006 SEC No-Act LEXIS 669 (2006); *Victoria Bancroft*, 1987 SEC No-Act LEXIS 2517 (1987); and *International Business Exchange Corp*., 1986 SEC No-Act LEXIS 3065 (1986).

[22] The SEC's general rules, specifically Rule 202.1(d), state that a no-action letter only expresses the SEC staff's view on the question presented—in this case the need for an M&A broker to register with the SEC. It is merely an interpretation that can be later modified or withdrawn. *See* the SEC's description of no-action letters on its website at http://www.sec.gov/answers/noaction.htm. Courts may give the SEC's no-action letter some deference but the staff's position is not legally binding on anyone, not even the Commission. *See New York City Employees Retirement System v. SEC*, 45 F.3d 7 (2d. Cir. 1995).

[23] As a general matter, and particularly in the context of the LCFB Rules, we strongly encourage FINRA to reconsider and repropose NASD Rule 3040 to better acknowledge and align the rule with present day realities in which particular employees may be dually employed by individual affiliates within a multi-service organization, many of which affiliates are separately regulated under different regulatory regimes and subject to different regulatory requirements. Requiring a FINRA member to "supervise" the employee's participation in securities-related activities performed in the context of their employment with a separately regulated (or exempt) affiliate as if the activity were performed on behalf of the member, and to "record" resulting securities-related transactions on the FINRA member's books and records, is not practical or appropriate and indeed may be inconsistent with the affiliate's applicable regulatory requirements.

are likely to find a significant cost-savings from bifurcating their M&A business with respect to privately held company transactions.

We note that an important unresolved question about the M&A Broker Letter is whether a FINRA member could pay a referral fee to an unregistered M&A broker for transactions coming within the scope of that no-action letter. In 2009, FINRA proposed to replace NASD Rule 2420 with a new FINRA Rule 2040 that would, in essence, allow payments or sharing of compensation with unregistered persons when, based on SEC rule or guidance, broker-dealer registration would not be required. The modernization of NASD Rule 2420 is long overdue. NASD Rule 2420 was first written and adopted for entirely different purposes and a literal reading of the rule today barely hints at its current application, creating a compliance trap for the unwary. While the proposed FINRA Rule 2040 could itself be written far more clearly, its reproposal is strongly encouraged.

Conclusion

We greatly appreciate the opportunity to share our thoughts and comments on the Proposal. FINRA has taken an important step forward in modernizing its rules in light of the dramatic shift in the demographics of its members and in recognition of the pending revolution in issuer-direct capital raising activities facilitated by The Jumpstart Our Business Startups Act of 2012 ("JOBS Act"). The 2013 SEC report, *Capital Raising in the U.S.: An Analysis of Unregistered Offerings Using the Regulation D Exemption, 2009-2012*,[24] documents the leading edge of these impending changes. Notably, the report's Summary of Main Findings highlights, among other points, that: "Only 13% of Regulation D offerings since 2009 report using a financial intermediary (broker-dealer or finder)". Neither this statistic nor the JOBS Act's innovations in general solicitation and crowdfunding bode well for the future revenues of FINRA's members, particularly smaller members who are still willing to undertake Regulation D private offerings. We are concerned that these developments may result in the further decline in FINRA small firm membership.

We believe that the Proposal is the first step in the right direction. We hope these comments will be helpful, both in consideration of the Proposal and in FINRA's retrospective rule review process. We are available to meet and discuss these matters with FINRA and to respond to any questions you may have. We greatly appreciate your consideration and look forward to future opportunities to provide further input.

[24] Available on the SEC's website at http://www.sec.gov/divisions/riskfin/whitepapers/dera-unregistered-offerings-reg-d.pdf

Very truly yours,

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