

respondent clearing agencies × 15 hours per Web site update) or 15 hours annualized over three years.

Respondent clearing agencies will also have to provide training to staff members using the Electronic Form 19b-4 Filing System (“EFFS”) to submit Security-Based Swap Submissions, Advance Notices, and/or proposed rule changes electronically. The Commission estimates that one anticipated security-based swap clearing agency will spend approximately 20 hours training all staff members who will use EFFS to submit Security-Based Swap Submissions, Advance Notices, and/or proposed rule changes electronically, or 6.7 hours annualized over three years. The Commission also estimates that one anticipated clearing agency will have a one-time burden of 130 hours to draft and implement internal policies and procedures for using EFFS to make these submissions, or 43.3 hours annualized over three years. The Commission estimates that each of the 39 respondents will spend 10 hours each year training new compliance staff members and updating the training of existing compliance staff members to use EFFS, for a total annual burden of 390 hours (39 respondent SROs × 10 hours).

In connection with Security-Based Swap Submissions, counterparties may apply for a stay from a mandatory clearing requirement under Rule 3Ca-1. The Commission estimates that each clearing agency will submit five applications for stays from a clearing requirement per year and it will take approximately 18 hours to retrieve, review, and submit each application. Thus, the total annual reporting burden for the Rule 3Ca-1 stay of clearing requirement would be 270 hours (3 respondent clearing agencies × 5 stay of clearing applications per year × 18 hours to retrieve, review, and submit the stay of clearing information).

Based on the above, the total estimated annual response burden pursuant to Rule 19b-4 and Form 19b-4 is the sum of the total annual reporting burdens for filing proposed rule changes, Advance Notices, and Security-Based Swap Submissions; training staff to file such proposals; drafting, modifying, and implementing internal policies and procedures for filing such proposals; posting each proposal on the respondents’ Web sites; updating Web sites to enable posting of proposals; updating the respondents’ online rulebooks to reflect the proposals that became effective; submitting copies of Advance Notices to the Board; and applying for stays from clearing requirements, which is 114,740 hours.

Compliance with Rule 19b-4 is mandatory. Information received in response to Rule 19b-4 shall not be kept confidential; the information collected is public information.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information under the PRA unless it displays a currently valid OMB control number.

The public may view background documentation for this information collection at the following Web site, [www.reginfo.gov](http://www.reginfo.gov). Comments should be directed to: (i) Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Office of Management and Budget, Room 10102, New Executive Office Building, Washington, DC 20503, or by sending an email to: [Shagufta\\_Ahmed@omb.eop.gov](mailto:Shagufta_Ahmed@omb.eop.gov); and (ii) Pamela Dyson, Director/Chief Information Officer, Securities and Exchange Commission, c/o Remi Pavlik-Simon, 100 F Street NE., Washington, DC 20549, or by sending an email to: [PRA\\_Mailbox@sec.gov](mailto:PRA_Mailbox@sec.gov). Comments must be submitted to OMB within 30 days of this notice.

Dated: August 19, 2016.

**Brent J. Fields,**

Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-78617; File No. SR-FINRA-2015-054]

### Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving Rule Change as Modified by Amendment Nos. 1 and 2 To Adopt FINRA Capital Acquisition Broker Rules

August 18, 2016.

#### I. Introduction

On December 4, 2015, the Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (the “Commission” or “SEC”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> proposed rule change SR-FINRA-2015-054, pursuant to which FINRA proposed to adopt a rule set that would apply exclusively to firms that meet the definition of “capital acquisition broker” (“CAB”) and that elect to be

governed under this rule set (collectively, the “CAB rules”).

The Commission published the proposed rule change for public comment in the **Federal Register** on December 23, 2015.<sup>3</sup> On January 28, 2016, FINRA extended the time period in which the Commission must approve the proposed rule change, disapprove the proposed rule change or institute proceedings to determine whether to approve or disapprove the proposed rule change to March 22, 2016. On March 17, 2016, the Commission instituted proceedings pursuant to Section 19(b)(2)(B) of the Exchange Act<sup>4</sup> to determine whether to approve or disapprove the proposed rule change.<sup>5</sup> The Commission received 18 comment letters on the proposal.<sup>6</sup>

In response to comments, on March 29, 2016 FINRA filed a partial amendment (“Amendment No. 1”) to its proposed rule change to amend CAB Rule 016(c)(2) to clarify that the definition of “capital acquisition broker” does not include any broker or

<sup>3</sup> Exchange Act Release No. 76675 (December 17, 2015), 80 FR 79969 (December 23, 2015) (Notice of Filing of File No. SR-FINRA-2015-054) (“Notice of Filing”).

<sup>4</sup> 15 U.S.C. 78s(b)(2)(B).

<sup>5</sup> Exchange Act Release No. 77391 (March 17, 2016), 81 FR 15588 (March 23, 2016) (Order Instituting Proceedings To Determine Whether to Approve or Disapprove Proposed Rule Change to Adopt FINRA Capital Acquisition Broker Rules on File No. SR-FINRA-2015-054).

<sup>6</sup> Letters from Peter W. LaVigne, Esq., Chair, Securities Regulation Committee, Business Law Section, New York State Bar Association, dated January 22, 2016 (“New York Bar Association Letter”); Judith M. Shaw, President, North American Securities Administrators Association, Inc., dated January 15, 2016 (“NASAA Letter”); Timothy Cahill, President, Compass Securities Corporation, dated January 13, 2016; Mark Fairbanks, President, Foreside Distributors, dated January 13, 2016 (“Foreside Letter”); Dan Glusker, Perkins Fund Marketing, LLC, dated January 13, 2016; Steven Jafarzadeh, CAIA, Managing Director, CCO Partner, Stonehaven, dated January 13, 2016; Richard A. Murphy, Manager, North Bridge Capital LLC, dated January 13, 2016; Ron Oldenkamp, President, Genesis Marketing Group, dated January 13, 2016; Michael S. Quinn, Member and CCO, Q Advisors LLC, dated January 13, 2016 (“Q Advisors Letter”); Lisa Roth, President, Monahan & Roth, LLC, dated January 13, 2016 (“Roth Letter”); Howard Spindel, Senior Managing Director, and Cassandra E. Joseph, Managing Director, Integrated Management Solutions USA LLC, dated April 8, 2016 (“IMS Letter 1”) and January 13, 2016 (“IMS Letter 2”); Sajan K. Thomas, President, and Stephen J. Myott, Chief Compliance Officer, Thomas Capital Group, Inc., dated January 13, 2016; Donna DiMaria, Chairman of the Board of Directors, and Lisa Roth, Board of Directors, Third Party Marketers Association, dated January 12, 2016 (“3PM Letter”); Frank P. L. Minard, Managing Partner, XT Capital Partners, LLC, dated January 12, 2016; Arne Rovell, Coronado Investments, LLC, dated January 6, 2016 (“Coronado Letter”); Daniel H. Kolber, President/CEO, Intellivest Securities, Inc., dated December 30, 2016 (“Intellivest Letter”); and Roger W. Mehle, Chairman and CEO, Achates Capital Advisors LLC, dated December 29, 2015 (“Achates Letter”).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

dealer that effects securities transactions that would require the broker or dealer to report the transaction under the FINRA Rules 6300 Series, 6400 Series, 6500 Series, 6600 Series, 6700 Series, 7300 Series or 7400 Series. The Commission published Amendment No. 1 for public comment in the **Federal Register** on April 15, 2016.<sup>7</sup> The Commission received one additional comment.<sup>8</sup>

FINRA filed a second amendment on June 28, 2016 (“Amendment No. 2”) to amend proposed CAB Rule 016(c)(1)(F) regarding a CAB’s authority to engage in qualifying, identifying, soliciting, or acting as a placement agent or finder in connection with unregistered securities transactions. The Commission published Amendment No. 2 for public comment in the **Federal Register** on July 7, 2016.<sup>9</sup> The Commission received one comment letter on Amendment No. 2.<sup>10</sup> FINRA responded to all of the comment letters on August 16, 2016.<sup>11</sup>

This order grants approval of the proposed rule change, as modified by Amendment Nos. 1 and 2.

## II. Description of the Rule Change<sup>12</sup>

FINRA states that there are firms that are solely corporate financing firms that advise companies on mergers and acquisitions, advise issuers on raising debt and equity capital in private placements with institutional investors, or provide advisory services on a consulting basis to companies that need assistance analyzing their strategic and financial alternatives. FINRA explains that these firms often are registered as broker-dealers because of their activities and because they may receive transaction-based compensation as part of their services. Nevertheless, FINRA believes that these firms do not engage in many of the types of activities typically associated with traditional broker-dealers. For example, these firms typically do not carry or act as an

introducing broker with respect to customer accounts, handle customer funds or securities, accept orders to purchase or sell securities either as principal or agent for the customer, exercise investment discretion on behalf of any customer, or engage in proprietary trading of securities or market-making activities. Therefore, FINRA proposed to create a separate rule set to apply to firms that meet the definition of CAB and elect to be governed under this rule set.

The proposed rules subject CABs to the FINRA By-Laws, as well as core FINRA rules that FINRA believes should apply to all of its members. The rule set applicable to CABs also includes other FINRA rules that are tailored to address CABs’ business activities. A brief description of the rule set for CABs is included below.

### A. General Standards

CAB Rule 014 provides that all persons that have been approved for membership in FINRA as a CAB and persons associated with CABs shall be subject to the CAB rules and the FINRA By-Laws (including the schedules thereto), unless the context requires otherwise. CAB Rule 015 provides that FINRA Rule 0150(b) shall apply to CABs. FINRA Rule 0150(b) provides that the FINRA rules do not apply to transactions in, and business activities relating to, municipal securities as that term is defined in the Exchange Act.

CAB Rule 016 sets forth basic definitions that apply to CABs. The proposed definitions of “capital acquisition broker” and “institutional investor” are particularly important to the application of the rule set. The term “capital acquisition broker” means any broker that solely engages in one or more of the following activities:

- Advising an issuer, including a private fund, concerning its securities offerings or other capital raising activities;
- 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;
- advising a company regarding its selection of an investment banker;
- assisting in the preparation of offering materials on behalf of an issuer;
- providing fairness opinions, valuation services, expert testimony, litigation support, and negotiation and structuring services;
- qualifying, identifying, soliciting, or acting as a placement agent or finder (i) on behalf of an issuer in connection with a sale of newly-issued, unregistered securities to institutional

investors or (ii) on behalf of an issuer or control person in connection with a change of control of a privately-held company. For purposes of this part, a “control person” is a person who has the power to direct the management or policies of a company through ownership of securities, by contract, or otherwise. Control will be presumed to exist if, before the transaction, the person has the right to vote or the power to sell or direct the sale of 25% or more of a class of voting securities or in the case of a partnership or limited liability company has the right to receive upon dissolution or has contributed 25% or more of the capital. Also, for purposes of this part, a “privately-held company” is a company that does not have any class of securities registered, or required to be registered, with the SEC under Section 12 of the Exchange Act or with respect to which the company files, or is required to file, periodic information, documents, or reports under Section 15(d) of the Exchange Act;<sup>13</sup> and

- effecting securities transactions solely in connection with the transfer of ownership and control of a privately-held company through the purchase, sale, exchange, issuance, repurchase, or redemption of, or a business combination involving, securities or assets of the company, to a buyer that will actively operate the company or the business conducted with the assets of the company, in accordance with the terms and conditions of an SEC rule, release, interpretation or “no-action” letter that permits a person to engage in such activities without having to register as a broker or dealer pursuant to Section 15(b) of the Exchange Act.<sup>14</sup>

A firm will be permitted to register as, or change its status to, a CAB *only* if the firm solely engages in one or more of these activities.

The term “capital acquisition broker” does not include any broker or dealer that:

- Carries or acts as an introducing broker with respect to customer accounts;
- holds or handles customers’ funds or securities;
- accepts orders from customers to purchase or sell securities either as principal or as agent for the customer (except as permitted by paragraphs (c)(1)(F) and (G) of CAB Rule 016);

<sup>13</sup> See Notice of Amendment No.2, *supra* note 9, 81 FR at 44373 (amending this prong of the proposed definition of CAB). Originally, this prong of the definition of CAB included a broker “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.” Notice of Filing, *supra* note 3, 80 FR at 79970.

<sup>14</sup> See CAB Rule 016(c)(1).

<sup>7</sup> Exchange Act Release No. 77581 (April 11, 2016), 81 FR 22333 (April 15, 2016) (Notice of Filing of Partial Amendment No. 1 to Proposed Rule Change to Adopt FINRA Capital Acquisition Broker Rules) (“Notice of Amendment No.1”).

<sup>8</sup> See letter from Anonymous dated May 3, 2016 (stating “Good”).

<sup>9</sup> Exchange Act Release No. 78220 (July 1, 2016), 81 FR 44372 (July 7, 2016) (Notice of Filing of Partial Amendment No. 2 to Proposed Rule Change to Adopt FINRA Capital Acquisition Broker Rules) (“Notice of Amendment No.2”).

<sup>10</sup> See letter from Kent J. Lund, SDR Capital Markets, Inc., dated July 15, 2016 (“SDR Letter”).

<sup>11</sup> See letter from Joseph Savage, FINRA, dated August 16, 2016 (“FINRA Response”).

<sup>12</sup> For a more detailed description of the proposed rule change, see the Notice of Filing, *supra* note 3, Notice of Amendment No.1, *supra* note 7, and Notice of Amendment No.2, *supra* note 9, which were substantially prepared by FINRA.

- has investment discretion on behalf of any customer;
- engages in proprietary trading of securities or market-making activities;
  - participates in or maintains an online platform in connection with offerings of unregistered securities pursuant to Regulation Crowdfunding or Regulation A under the Securities Act of 1933; or
  - effects securities transactions that will require the broker or dealer to report the transaction under the FINRA Rules 6300 Series, 6400 Series, 6500 Series, 6600 Series, 6700 Series, 7300 Series or 7400 Series.<sup>15</sup>

The term “institutional investor” has substantially the same meaning as that term has under FINRA Rule 2210 (Communications with the Public). The term includes any:

- Bank, savings and loan association, insurance company or registered investment company;
- governmental entity or subdivision thereof;
- employee benefit plan, or multiple employee benefit plans offered to employees of the same employer, that meet the requirements of Section 403(b) or Section 457 of the Internal Revenue Code and in the aggregate have at least 100 participants, but does not include any participant of such plans;
- qualified plan, as defined in Section 3(a)(12)(C) of the Exchange Act, or multiple qualified plans offered to employees of the same employer, that in the aggregate have at least 100 participants, but does not include any participant of such plans;
- other person (whether a natural person, corporation, partnership, trust, family office or otherwise) with total assets of at least \$50 million;
- person meeting the definition of “qualified purchaser” as that term is defined in Section 2(a)(51) of the Investment Company Act of 1940 (“1940 Act”); and
- person acting solely on behalf of any such institutional investor.

#### B. FINRA Membership

The CAB Rule 100 Series sets forth the requirements for a firm that wishes to register as a CAB. The CAB Rule 100 Series generally incorporates by reference FINRA Rules 1010 (Electronic Filing Requirements for Uniform Forms), and 1122 (Filing of Misleading

Information as to Membership or Registration), and NASD Rules 1011 (Definitions), 1012 (General Provisions), 1013 (New Member Application and Interview), 1014 (Department Decision), 1015 (Review by National Adjudicatory Council), 1016 (Discretionary Review by FINRA Board), 1017 (Application for Approval of Change in Ownership, Control, or Business Operations), 1019 (Application to Commission for Review), 1090 (Foreign Members), 1100 (Foreign Associates) and IM-1011-1 (Safe Harbor for Business Expansions). Accordingly, a CAB applicant will follow the same procedures for membership as any other FINRA applicant, with four modifications.

- First, an applicant for membership that seeks to qualify as a CAB will have to state in its application that it intends to operate solely as such.
- Second, in reviewing an application for membership as a CAB, the FINRA Member Regulation Department will consider, in addition to the standards for admission set forth in NASD Rule 1014, whether the applicant’s proposed activities are consistent with the limitations imposed on CABs under CAB Rule 016(c).
- Third, CAB Rule 116(b) sets forth the procedures for an existing FINRA firm to change its status to a CAB. If an existing firm is already approved to engage in the activities of a CAB, and the firm does not intend to change its existing ownership, control or business operations, it will not be required to file either a New Member Application (“NMA”) or a Change in Membership Application (“CMA”). Instead, the firm will be required to file a request to amend its membership agreement or obtain a membership agreement (if none exists currently) to provide that: (i) The firm’s activities will be limited to those permitted for CABs under CAB Rule 016(c), and (ii) the firm agrees to comply with the CAB rules.<sup>16</sup>

• Fourth, CAB Rules 116(c) and (d) set forth the procedures for an existing CAB to terminate its status as such and continue as a FINRA firm. Under Rule 116(c), such a firm will be required to file a CMA with the FINRA Member Regulation Department, and to amend its membership agreement to provide that the firm agrees to comply with all FINRA rules.<sup>17</sup>

Under CAB Rule 116(d), however, if during the first year following an existing FINRA member firm’s

amendment to its membership agreement to convert a full-service broker-dealer to a CAB pursuant to Rule 116(b) a CAB seeks to terminate its status as such and continue as a FINRA member firm, the CAB may notify the FINRA Membership Application Program group of this change without having to file an application for approval of a material change in business operations pursuant to NASD Rule 1017. The CAB will instead file a request to amend its membership agreement to provide that the member firm agrees to comply with all FINRA rules, and execute an amended membership agreement that imposes the same limitations on the member firm’s activities that existed prior to the member firm’s change of status to a CAB.<sup>18</sup>

The CAB Rule 100 Series also governs the registration and qualification examinations of principals and representatives that are associated with CABs. These rules incorporate by reference NASD Rules 1021 (Registration Requirements—Principals), 1022 (Categories of Principal Registration), 1031 (Registration Requirements—Representatives), 1032 (Categories of Representative Registration), 1060 (Persons Exempt from Registration), 1070 (Qualification Examinations and Waiver of Requirements), 1080 (Confidentiality of Examinations), IM-1000-2 (Status of Persons Serving in the Armed Forces of the United States), IM-1000-3 (Failure to Register Personnel) and FINRA Rule 1250 (Continuing Education Requirements). Accordingly, CAB firm principals and representatives are subject to the same registration, qualification examination, and continuing education requirements as principals and representatives of other FINRA firms. CABs are also subject to FINRA Rule 1230(b)(6) regarding Operations Professional registration.

#### C. Conduct Rules (CAB Rule 200 Series)

The CAB Rule 200 Series establishes a streamlined set of conduct rules. CABs are subject to FINRA Rules 2010 (Standards of Commercial Honor and Principles of Trade), 2020 (Use of Manipulative, Deceptive or Other Fraudulent Devices), 2040 (Payments to Unregistered Persons), 2070 (Transactions Involving FINRA Employees), 2080 (Obtaining an Order of Expungement of Customer Dispute Information from the CRD System), 2081

<sup>15</sup> See CAB Rule 016(c)(2). The original rule in the Notice of Filing was amended by Amendment No. 1, which clarified that CABs may engage in secondary transactions only if they are not subject to FINRA Rules 6300 Series, 6400 Series, 6500 Series, 6600 Series, 6700 Series, 7300 Series or 7400 Series. See Notice of Amendment No.1, *supra* note 7, 81 FR at 22333.

<sup>16</sup> There will not be an application fee associated with this request.

<sup>17</sup> Absent a waiver, such a firm will have to pay an application fee associated with the CMA. See FINRA By-Laws, Schedule A, Section 4(i).

<sup>18</sup> To the extent that the rules applicable to the member firm had been amended since it had changed its status to a CAB, FINRA will have the discretion to modify any limitations to reflect any new rule requirements.

(Prohibited Conditions Relating to Expungement of Customer Dispute Information), 2263 (Arbitration Disclosure to Associated Persons Signing or Acknowledging Form U4), and 2268 (Requirements When Using Predispute Arbitration Agreements for Customer Accounts).

CAB Rules 209 and 211 impose know-your-customer and suitability obligations similar to those imposed under FINRA Rules 2090 and 2111. CAB Rule 211(b) includes an exception to the customer-specific suitability obligations for institutional investors similar to the exception found in FINRA Rule 2111(b). CAB Rule 221 is an abbreviated version of FINRA Rule 2210 (Communications with the Public), essentially prohibiting false and misleading statements.

Under CAB Rule 240, if a CAB or associated person of a CAB has engaged in activities that require the CAB to register as a broker or dealer under the Exchange Act, and that are inconsistent with the limitations imposed on CABs under CAB Rule 016(c), FINRA could examine for and enforce all FINRA rules against such a broker-dealer or associated person, including any rule that applies to a FINRA member that is not a CAB or to an associated person who is not a person associated with a CAB.<sup>19</sup>

FINRA is not subjecting CABs to FINRA Rules 2121 (Fair Prices and Commissions), 2122 (Charges for Services Performed), and 2124 (Net Transactions with Customers). FINRA Rule 2121 provides that, for both listed and unlisted securities, a member that buys for its own account from its customer, or sells for its own account to its customer, shall buy or sell at a price that is fair, taking into consideration all relevant circumstances, including market conditions with respect to the security at the time of the transaction, the expense involved, and the fact that the member is entitled to a profit. Further, if the member acts as agent for its customer in any such transaction, the member shall not charge its customer more than a fair commission or service charge, taking into consideration all relevant circumstances, including market conditions with respect to the security at the time of the transaction, the expense of executing the order and the value of any service the member

may have rendered by reason of its experience in and knowledge of such security and the market therefor.

A CAB is not permitted to act as principal in a securities transaction. Accordingly, the provisions of FINRA Rule 2121 that govern principal transactions do not apply to a CAB's permitted activities. However, CABs are permitted to qualify, identify, solicit or act as placement agent or finder in a securities transaction, although only in very narrow circumstances on behalf of an issuer in connection with a sale of newly-issued, unregistered securities to institutional investors or on behalf of an issuer or control person in connection with a change of control of a privately-held company. CABs also are permitted to effect securities transactions solely in connection with the transfer of ownership and control of a privately-held company to a buyer that will actively operate the company or the business conducted with the assets of the company in accordance with the terms and conditions of an SEC rule, release, interpretation or "no-action" letter. FINRA believes that these narrow circumstances either involve institutional parties that are generally capable of negotiating fair prices, or involve the sale of a business as a going concern, which differ in nature from the types of transactions that typically raise issues under FINRA Rule 2121.<sup>20</sup>

FINRA Rule 2122 provides that charges, if any, for services performed, including, but not limited to, miscellaneous services such as collections due for principal, dividends, or interest; exchange or transfer of securities; appraisals, safekeeping or custody of securities, and other services shall be reasonable and not unfairly discriminatory among customers. FINRA believes that CABs typically provide services to institutional customers that are capable of negotiating reasonable service charges.<sup>21</sup> Moreover, CABs are not permitted to provide many of the services listed in Rule 2122, such as collecting principal, dividends or interest, or providing safekeeping or custody services.

FINRA Rule 2124 sets forth specific requirements for executing transactions with customers on a "net" basis. "Net" transactions are defined as a type of principal transaction, and CABs may not trade securities on a principal basis. Thus, FINRA does not believe it is necessary to include FINRA Rule 2124 as part of the CAB rule set.

Notwithstanding the foregoing, CAB Rule 201 will subject CABs to FINRA

Rule 2010 (Standards of Commercial Honor and Principles of Trade), which requires a member, in the conduct of its business, to observe high standards of commercial honor and just and equitable principles of trade. FINRA notes that, depending on the facts, CAB Rule 201 may apply in situations in which a CAB charged a commission or fee that clearly is unreasonable under the circumstances.

#### *D. Supervision and Responsibilities Related to Associated Persons (CAB Rule 300 Series)*

The CAB Rule 300 Series establishes a limited set of supervisory rules for CABs. CABs are subject to FINRA Rules 3220 (Influencing or Rewarding Employees of Others), 3240 (Borrowing from or Lending to Customers), and 3270 (Outside Business Activities of Registered Persons).

CAB Rule 311 subjects CABs to some, but not all, of the requirements of FINRA Rule 3110 (Supervision) and, consistent with Rule 3110, is designed to provide CABs with the flexibility to tailor their supervisory systems to their business models. CABs are subject to the provisions of Rule 3110 concerning the supervision of offices, personnel, customer complaints, correspondence and internal communications. However, CABs are not subject to the provisions of Rule 3110 that require annual compliance meetings (paragraph (a)(7)), review and investigation of transactions (paragraphs (b)(2) and (d)), specific documentation and supervisory procedures for supervisory personnel (paragraph (b)(6)), and internal inspections (paragraph (c)).

FINRA does not believe that the annual compliance meeting requirement in FINRA Rule 3110(a)(7) should apply to CABs given the nature of their business model and structure. FINRA has observed that most current FINRA member firms that would qualify as CABs tend to be small and often operate out of a single office. In addition, the range of rules that CABs are subject to is narrower than the rules that apply to other broker-dealers. Moreover, as noted above, CABs are subject to both the Regulatory and Firm Element continuing education requirements. Accordingly, FINRA does not believe that CABs need to conduct an annual compliance meeting as required under FINRA Rule 3110(a)(7). The fact that the annual compliance meeting requirement does not apply to CABs or their associated persons is in no way intended to reduce their responsibility to have knowledge of and comply with applicable securities laws and regulations and the CAB rule set.

<sup>19</sup> FINRA states that the purpose of this rule is to clarify that the full FINRA Rulebook would apply if a CAB engages in broker-dealer activities that are inconsistent with the limitations imposed on CABs. FINRA believes that, without CAB Rule 240, it might be unclear which rules would apply to a firm that elected CAB status and yet engaged in brokerage activities that are impermissible for a CAB. See FINRA Response, *supra* note 11, at 18.

<sup>20</sup> See FINRA Response, *supra* note 11, at 16.

<sup>21</sup> *Id.*

FINRA also does not believe that FINRA Rule 3110(b)(2), which requires members to adopt and implement procedures for the review by a registered principal of all transactions relating to the member's investment banking or securities business, or FINRA Rule 3110(d), which imposes requirements related to the investigation of securities transactions and heightened reporting requirements for members engaged in investment banking services, should apply to CABs. CABs are not permitted to carry or act as an introducing broker with respect to customer accounts, hold or handle customers' funds or securities, accept orders from customers to purchase or sell securities (except as permitted by CAB Rule 016(c)(1)(F) and (G)), have investment discretion on behalf of any customer, engage in proprietary trading or market-making activities, or participate in Crowdfunding or Regulation A securities offerings. Accordingly, due to these restrictions, FINRA does not believe a CAB's business model necessitates the application of these provisions, which primarily address trading and investment banking functions that are beyond the permissible scope of a CAB's activities.

FINRA also does not believe that the requirements of FINRA Rule 3110(b)(6) should apply to CABs. Paragraph (b)(6) generally requires a member to have procedures to prohibit its supervisory personnel from: (1) Supervising their own activities; and (2) reporting to, or having their compensation or continued employment determined by, a person the supervisor is supervising.<sup>22</sup> In addition, FINRA does not believe that FINRA Rule 3110(c), which requires members to conduct internal inspections of their businesses, should apply to CABs.

FINRA believes that it is providing CABs with flexibility to tailor their supervisory structures to their business model, which is geared toward acting as a consultant in capital acquisition

<sup>22</sup> FINRA Rule 3110(b)(6)(C)(i) and (ii). FINRA Rule 3110(b)(6) also requires that a member's supervisory procedures include the titles, registration status and locations of the required supervisory personnel and the responsibilities of each supervisory person as these relate to the types of business engaged in, applicable securities laws and regulations, and FINRA rules, as well as a record of the names of its designated supervisory personnel and the dates for which such designation is or was effective. FINRA Rule 3110(b)(6)(A) and (B). In addition, paragraph (b)(6) requires a member to have procedures reasonably designed to prevent the standards of supervision required pursuant to FINRA Rule 3110(a) from being compromised due to the conflicts of interest that may be present with respect to an associated person being supervised. FINRA Rule 3110(b)(6)(D).

transactions, qualifying, identifying, soliciting or acting as placement agent or finder in a securities transaction solely on behalf of an issuer in connection with a sale of newly-issued, unregistered securities to institutional investors or on behalf of an issuer or a control person in connection with a change of control of a privately-held company, or with the transfer of ownership and control of a privately-held company. As discussed above, many CABs operate out of a single office with a small staff, which reduces the need for internal inspections of numerous or remote offices. In addition, part of the purpose of creating a separate CAB rule set is to streamline and reduce existing FINRA rule requirements where doing so does not hinder investor protection. FINRA believes that the remaining provisions of FINRA Rule 3110, coupled with the CAB Rule 200 Series addressing duties and conflicts will sufficiently protect CABs' customers from potential harm due to insufficient supervision.

CAB Rule 313 requires CABs to designate and identify one or more principals to serve as a firm's chief compliance officer ("CCO"), similar to the requirements of FINRA Rule 3130(a). FINRA Rule 3130 requires a CAB to have its chief executive officer ("CEO") certify that the member has in place processes to establish, maintain, review, test and modify written compliance policies and written supervisory procedures reasonably designed to achieve compliance with applicable federal securities laws and regulations, and FINRA and MSRB rules, which are required under FINRA Rules 3130(b) and (c). FINRA does not believe the CEO certification is necessary given a CAB's narrow business model and smaller rule set.

CAB Rule 328 prohibits any person associated with a CAB from participating in any manner in a private securities transaction as defined in FINRA Rule 3280(e).<sup>23</sup> FINRA does not believe that an associated person of a CAB should be engaged in selling securities away from the CAB, nor should a CAB have to oversee and review such transactions, given its

<sup>23</sup> FINRA Rule 3280(e) defines "private securities transaction" as "any securities transaction outside the regular course or scope of an associated person's employment with a member, including, though not limited to, new offerings of securities which are not registered with the Commission, provided however that transactions subject to the notification requirements of NASD Rule 3050, transactions among immediate family members (as defined in FINRA Rule 5130), for which no associated person receives any selling compensation, and personal transactions in investment company and variable annuity securities, shall be excluded."

limited business model. This restriction does not prohibit associated persons from investing in securities on their own behalf, or engaging in securities transactions with immediate family members, provided that the associated person does not receive selling compensation.

CAB Rule 331 requires each CAB to implement a written anti-money laundering ("AML") program. FINRA believes that this is consistent with the SEC's requirements and Chapter X of Title 31 of the Code of Federal Regulations. Accordingly, CAB Rule 331 is similar to FINRA Rule 3310 (Anti-Money Laundering Compliance Program); however, the CAB rule contemplates that all CABs will be eligible to conduct the required independent testing for compliance every two years (rather than annually as FINRA Rule 3310 requires of non-CAB members).

#### *E. Financial and Operational Rules (CAB Rule 400 Series)*

The CAB Rule 400 Series establishes a streamlined set of rules concerning firms' financial and operational obligations. CABs are subject to FINRA Rules 4140 (Audit), 4150 (Guarantees by, or Flow through Benefits for, Members), 4160 (Verification of Assets), 4511 (Books and Records—General Requirements), 4513 (Records of Written Customer Complaints), 4517 (Member Filing and Contact Information Requirements), 4524 (Supplemental FOCUS Information), 4530 (Reporting Requirements), and 4570 (Custodian of Books and Records). Under CAB Rule 411, which is modeled after FINRA Rule 4110, CABs are required to suspend business operations during any period a firm is not in compliance with the applicable net capital requirements set forth in Exchange Act Rule 15c3-1, and CAB Rule 411 also authorizes FINRA to direct a CAB to suspend its operation under those circumstances.<sup>24</sup> The CAB rules also set forth requirements concerning withdrawal of capital, subordinated loans, notes collateralized by securities, and capital borrowings.

Because CABs may not carry or act as an introducing broker with respect to customer accounts, they will have more limited customer information requirements than those imposed under FINRA Rule 4512.<sup>25</sup> Pursuant to CAB Rule 451, CABs will have to maintain each customer's name and residence, whether the customer is of legal age (if applicable), and the names of any persons authorized to transact business

<sup>24</sup> See CAB Rule 411.

<sup>25</sup> See CAB Rule 451(b).

on behalf of the customer. CABs will still have to make and preserve all books and records required under Exchange Act Rules 17a-3 and 17a-4.<sup>26</sup> CABs are subject to a limited set of requirements for the supervision and review of a firm's general ledger accounts.<sup>27</sup>

CABs are not subject to FINRA Rules 4370 (Business Continuity Plans and Emergency Contact Information) or 4380 (Mandatory Participation in FINRA BC/DR Testing under Regulation SCI). FINRA does not believe it is necessary to have a rule requiring a CAB to maintain a business continuity plan ("BCP"), given a CAB's limited activities, particularly since a CAB will not engage in retail customer transactions or clearance, settlement, trading, underwriting or similar investment banking activities. FINRA Rule 4380 relates to Rule SCI under the Exchange Act, which is not applicable to a member that limits its activities to those permitted under the CAB rule set.

#### *F. Securities Offerings (CAB Rule 500 Series)*

The CAB Rule 500 Series subjects CABs to FINRA Rules 5122 (Private Placements of Securities Issued by Members) and 5150 (Fairness Opinions).

#### *G. Investigations and Sanctions, Code of Procedure, and Arbitration and Mediation (CAB Rules 800, 900 and 1000)*

CAB Rule 800 provides that CABs are subject to the FINRA Rule 8000 Series governing investigations and sanctions of firms, other than FINRA Rules 8110 (Availability of Manual to Customers), 8211 (Automated Submission of Trading Data Requested by FINRA), and 8213 (Automated Submission of Trading Data for Non-Exchange-Listed Securities Requested by FINRA).

CABs are not subject to FINRA Rule 8110 (Availability of Manual to Customers), which requires members to make available a current copy of the FINRA manual for examination by customers upon request. FINRA represents that it will make the CAB rule set available through the FINRA Web site. Accordingly, FINRA does not believe this rule is necessary for CABs.

CABs also are not subject to FINRA Rules 8211 (Automated Submission of Trading Data Requested by FINRA) or 8213 (Automated Submission of Trading Data for Non-Exchange-Listed Securities Requested by FINRA). Given that these rules are intended to assist FINRA in requesting trade data from firms engaged in securities trading, and that

CABs will not engage in securities trading, FINRA does not believe that these rules should apply to CABs.

CAB Rule 900 provides that CABs are subject to the FINRA Rule 9000 Series governing disciplinary and other proceedings involving firms, other than the FINRA Rule 9700 Series (Procedures on Grievances Concerning the Automated Systems). CAB Rule 900(c) provides that any CAB may be subject to a fine under FINRA Rule 9216(b) with respect to an enumerated list of FINRA By-Laws, CAB rules and SEC rules under the Exchange Act. CAB Rule 900(d) authorizes FINRA staff to require a CAB to file communications with the FINRA Advertising Regulation Department at least ten days prior to use if the staff determined that the CAB had departed from CAB Rule 221's standards.<sup>28</sup>

CAB Rule 1000 provides that CABs are subject to the FINRA Rule 12000 Series (Code of Arbitration Procedure for Customer Disputes), 13000 Series (Code of Arbitration Procedure for Industry Disputes) and 14000 Series (Code of Mediation Procedure).

FINRA states that if the Commission approves the rule change it will announce the implementation date of the rule change in a *Regulatory Notice* to be published no later than 60 days following Commission approval, and that such date will be no later than 180 days following publication of the *Regulatory Notice*.

### **III. Discussion of Comment Letters, FINRA's Response and Commission Findings**

After careful review of the proposed rule change, the comment letters, and FINRA's response to the comments, the Commission finds that the rule change, as modified by Amendment Nos. 1 and 2, is consistent with the requirements of the Exchange Act and the rules and regulations thereunder that are applicable to a national securities

<sup>28</sup> CAB Rule 221 states that: (a) No communication with the public by a capital acquisition broker may: (1) Include any false, exaggerated, unwarranted, promissory or misleading statement or claim; (2) omit any material fact or qualification if the omission, in light of the context of the material presented, would cause the communication to be misleading; (3) state or imply that FINRA, or any other corporate name or facility owned by FINRA, or any other regulatory organization endorses, indemnifies, or guarantees the capital acquisition broker-dealer's business practices; or (4) imply that past performance will recur or make any exaggerated or unwarranted claim, opinion or forecast. Further, the rule requires that all communications by a capital acquisition broker must be based on principles of fair dealing and good faith, must be fair and balanced, and must provide a sound basis for evaluating the facts in regard to any particular security or type of security, industry, or service.

association.<sup>29</sup> Specifically, the Commission finds that the rule change is consistent with Section 15A(b)(6) of the Exchange Act,<sup>30</sup> which requires, among other things, that FINRA rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.

The Commission received a total of twenty comment letters and FINRA's response to those comment letters. Commenters were generally supportive of the proposal but had suggestions regarding areas where certain aspects of the proposal could be expanded or further explained.<sup>31</sup> The Commission has considered the commenters' suggestions and FINRA's response and believes, as discussed below, that the CAB rules as amended are reasonably designed to provide flexibility for CABs, while providing for protection of investors and the public interest consistent with Section 15A(b)(6) of the Exchange Act.<sup>32</sup>

<sup>29</sup> In approving this rule change, the Commission has considered the rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>30</sup> 15 U.S.C. 78o-3(b)(6).

<sup>31</sup> Several commenters request certain changes to SEC rules and other requirements that apply to CABs, including, for example, eliminating financial responsibility rules, net capital requirements, Securities Investor Protection Corporation requirements and financial audits for CABs. See generally Achates Letter, *supra* note 6; Q Advisors Letter, *supra* note 6; 3PM Letter, *supra* note 6; and IMS Letter 1, *supra* note 6. FINRA responds that such changes are outside its authority. Further, the Commission believes that such changes are also outside the scope of the proposed rule change, and thus, we are not proposing to amend these requirements at this time.

<sup>32</sup> One commenter suggests that the Commission, FINRA, and NASAA should cooperate to more fully analyze the interaction between the CAB proposal and state registration requirements to better harmonize the application of these provisions. See NASAA Letter. This commenter suggests that the most relevant provisions of the CAB rule set is CAB Rule 016(c)(1)(G) (*i.e.*, mergers and acquisition brokers). The commenter indicates that it will welcome the opportunity to work with FINRA and the Commission on the issues presented by the proposal (including related to mergers and acquisitions brokers), and encourages the Commission to delay approval of the proposed rule change until there has been an opportunity to more fully explore these issues.

In response, FINRA states that it disagrees that the SEC should delay acting on the CAB proposal. FINRA notes that the definition of CAB will permit CABs to engage, among other activities, in mergers and acquisition transactions. While FINRA acknowledges that NASAA has adopted a model rule for mergers and acquisition brokers, it does not believe that any differences between the NASAA model rule and the CAB rules should preclude the SEC from approving its proposal. See FINRA Response, *supra* note 11, at 27.

The Commission notes that approval of FINRA's proposed rule change will not preclude further coordination and discussion with FINRA and NASAA.

<sup>26</sup> See CAB Rule 900(c).

<sup>27</sup> See CAB Rule 452(a).

## A. General Standards and FINRA Membership

### 1. By-laws

CAB Rule 014 requires that all persons that have been approved for membership in FINRA as a CAB and their associated persons shall be subject to the CAB rules and FINRA By-Laws (including the schedules thereto) “unless the context requires otherwise.” CAB Rule 014 also states that the terms used in the CAB rules, if defined in the FINRA By-Laws, shall have the same meaning as defined in the FINRA By-Laws, unless a term is defined differently in a CAB rule, “or unless the context of a term within a Capital Acquisition Broker Rule requires a different meaning.”<sup>33</sup>

One commenter expresses concern that there is no guidance as to what “context” may “require otherwise” and when and under what circumstances. This commenter suggests that this language sets up an interpretive issue and will make it impossible to advise a client as to what the actual definition is and, more significantly, whether it applies in a particular context.<sup>34</sup> In response, FINRA states that, as a general matter, the FINRA By-Laws’ provisions would apply as written, without the need to interpret them differently as applied to CABs. FINRA states that there may be on occasion situations in which reading a By-Law provision literally would lead to a clearly incorrect result, due to the differences between the CAB Rules and other FINRA Rules governing non-CAB firms. FINRA does not believe that this qualification for context creates an interpretive issue, nor would it be impossible to advise clients on how to comply with the FINRA By-Laws. FINRA also explains that the Commission approved similar qualifying language regarding application of the FINRA By-Laws in the recently adopted Funding Portal Rules.<sup>35</sup>

### 2. Review of Membership Application

CAB Rules 101 through 115 generally apply the same standards for new member applications by CAB applicants as those that apply to non-CAB FINRA member firm applicants. CAB Rule 116 generally applies the same standards regarding changes in ownership, control or business operations to CABs as those that apply to non-CAB firms.<sup>36</sup> One

commenter suggests that FINRA should approve the membership applications of new CABs within 60 days of the filing of the application (instead of 180 days as provided for in CAB Rule 113), provided that certain conditions are met, including: A completed application; 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.<sup>37</sup>

In response, FINRA states that it does not agree that it should revise its proposed rules to require it to act on a CAB’s NMA within 60 days of filing an application that meets certain conditions.<sup>38</sup> FINRA believes that its Membership Application Program staff often will need more than 60 days to conduct a proper investigation of an applicant and complete other tasks associated with broker-dealer applications, such as a membership interview.<sup>39</sup>

### 3. Grace Period

CAB Rule 116 provides that if during the first year following an existing FINRA member’s amendment electing to become a CAB the firm seeks to terminate its status as such and continue as a full FINRA member, the CAB may notify FINRA of this change without having to file an application for approval of a material change in business operations. One commenter states its view that this one-year grace period is not a sufficient amount of time for a firm to determine if CAB status is appropriate for its business model.<sup>40</sup> The commenter believes its view that a converted firm may not have sufficient data within the first year to evaluate its decision fully, and recommends that this grace period be extended to at least 24 months or that there be no grace time restrictions at all.<sup>41</sup> This commenter also suggests that FINRA allow interim continued operations as a CAB (provided the firm is in regulatory compliance) while an active CMA is being reviewed by FINRA, with the firm remaining subject to all the CAB rules pending a final decision by FINRA on the CMA.<sup>42</sup> Another commenter recommends that FINRA consider a grace period for firms that unintentionally conduct activities

beyond the scope of a CAB’s permissible activities.<sup>43</sup>

In response, FINRA states that it does not believe that the grace period during which a CAB may revert back to its prior non-CAB status should be lengthened.<sup>44</sup> FINRA believes that 12 months will give CABs sufficient time to make the determination of whether this status works for a firm’s business model. FINRA states that a CAB may still change its status to a full FINRA member firm after 12 months by filing a CMA. However, FINRA agrees that a CAB that determines to terminate its status as such and revert back to a non-CAB firm should be permitted to continue to operate as a CAB while its CMA or application to amend its membership agreement is pending, barring unusual circumstances.<sup>45</sup> With respect to a grace period for impermissible activities, FINRA states that it does not believe it is necessary.<sup>46</sup> FINRA believes that unintentional violations of the CAB rules are best handled through the examination and enforcement process on a case-by-case basis. FINRA believes it may be useful to provide additional guidance to CABs concerning the scope of permissible activities, and may do so through FAQs or other means.<sup>47</sup>

After reviewing the CAB rules relating to the application of the FINRA By-laws and membership application process, the Commission believes that these rules are consistent with Section 15A(b)(6), in particular the requirements that FINRA’s rules be reasonably designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. In particular, given the limited activity of CABs, the Commission believes that it is reasonable for FINRA to provide a certain amount of flexibility through the use of the concept “unless the context otherwise requires” in the application of the By-laws and the definitions within the By-laws to CABs and the CAB Rules, so as to provide for a certain amount of flexibility if needed. The Commission notes that FINRA has committed to work with its members if interpretive issues arise. The Commission also believes it is reasonable for FINRA to provide for the same amount of time for approval of new CAB member applications as for non-CAB applications, to help ensure that FINRA

<sup>33</sup> CAB Rule 014.

<sup>34</sup> See IMS Letter 2, *supra* note 6, at 3.

<sup>35</sup> See FINRA Funding Portal Rule 100(a).

<sup>36</sup> See NASD Rule 1017 (Application for Approval of Change in Ownership, Control or Business Operations).

<sup>37</sup> See New York State Bar Association Letter, *supra* note 6, at 1.

<sup>38</sup> See FINRA Response, *supra* note 11, at 14.

<sup>39</sup> *Id.*

<sup>40</sup> *Id.*

<sup>41</sup> See IMS Letter 1, *supra* note 6, at 11.

<sup>42</sup> *Id.*

<sup>43</sup> See 3PM Letter, *supra* note 6, at 3.

<sup>44</sup> See FINRA Response, *supra* note 11, at 14.

<sup>45</sup> *Id.*

<sup>46</sup> *Id.*

<sup>47</sup> *Id.* at 19.

has sufficient time to engage in its new member application process. In addition, the Commission believes FINRA's determination that a one year grace period for a firm to revert back to full member status is reasonably designed to provide a sufficient amount of time for a firm to determine whether CAB status makes sense for the firm, while not providing too long of a period without requiring the protections of going through the full membership process.<sup>48</sup> With respect to a grace period for impermissible activities, the Commission believes that it is appropriate for FINRA to address unintentional violations of the CAB rules through its examination and enforcement process on a case-by-case basis, and notes that FINRA states that it may provide additional guidance to CABs concerning the scope of permissible activities.

### B. Registration and Licensing

The CAB Rule 100 Series incorporates various NASD rules relating to the registration and qualification examinations of principals and representatives associated with CABS. Thus CAB firm principals and representatives are subject to the same registration, qualification examinations, and continued requirements as that of non-CAB FINRA member firms. One commenter suggests that FINRA should establish new examinations specifically for the registered representatives and supervisory principals of CABs that would test only that subject matter relevant to the business of CABs.<sup>49</sup> In response, FINRA states that it believes it is premature to establish new examinations at this point and may monitor the need in the future.<sup>50</sup>

Two commenters request that FINRA clarify whether CABs may hold all registration and licenses previously attained by their associated persons, including Series 53, 4 and other licenses.<sup>51</sup> One of these commenters also suggests that CABs should not be subject to FINRA Rule 1230(b)(6)<sup>52</sup>

regarding Operations Professional registration because of the scope and nature of the examination.<sup>53</sup> In addition, the other commenter suggests that FINRA should exempt a CAB CCO from FINRA's proposed requirement<sup>54</sup> to obtain and maintain the Series 14 CCO license because of the broad and comprehensive scope of the proposed license.<sup>55</sup>

In response, FINRA states that associated persons of CABs will only be permitted to retain registrations and licenses that are appropriate to their functions.<sup>56</sup> FINRA notes that this standard applies to non-CAB member firms as well as to CABs. Further, FINRA does not agree that CABs should be exempt from FINRA Rule 1230(b)(6).<sup>57</sup> FINRA believes that many of the functions for which an Operations Professional is responsible apply to all types of broker-dealers, including CABs. For example, FINRA states that firm account management and reconciliation, maintaining a general ledger and treasury, and preparing and filing regulatory reports apply to CABs as well as other broker-dealers. Accordingly, FINRA declines to eliminate this requirement for CABs. FINRA also states that given that its contemplated proposal to put in place an examination for CCOs is still under review at FINRA, and subject to filing with the SEC, it is premature to exempt CABs from this proposal.<sup>58</sup>

The Commission believes that it is reasonable for FINRA to first assess the potential need for new examinations specific to CAB activities before determining whether such action is necessary or appropriate, particularly given that associated persons of CABs will be subject to existing FINRA examination requirements that apply to all members, including CABs, to the extent they apply to their CAB activities

a supervisor, manager or other person responsible for approving or authorizing work, including work of other persons, in direct furtherance of each of the covered functions in the Rule, as applicable, provided that there is sufficient designation of such persons by senior management to address each of the applicable covered functions; and (iii) Persons with the authority or discretion materially to commit a member's capital in direct furtherance of the covered functions in the Rule or to commit a member to any material contract or agreement (written or oral) in direct furtherance of the covered functions in the Rule.

<sup>53</sup> See 3PM Letter, *supra* note 6, at 2.

<sup>54</sup> FINRA is separately considering a proposal to establish a new stand-alone registration category for compliance officers. Before it would implement such a proposal, FINRA would need to file a notice with the Commission, which would be subject to review and comment.

<sup>55</sup> See Roth Letter, *supra* note 6, at 1.

<sup>56</sup> See FINRA Response, *supra* note 11, at 15.

<sup>57</sup> *Id.*

<sup>58</sup> *Id.*

and functions. In this regard, the Commission agrees that it is reasonable to subject CABs to the FINRA operations professional registration rules, given that many of the functions for which an operations professional is responsible would apply to all types of FINRA member firms, including CABs. Likewise, the Commission believes that it is reasonable for FINRA to apply the same standard regarding the retention of licenses by associated persons to CAB member firms and non-CAB member firms. Thus, the Commission believes that the CAB registration and licensing rules are consistent with requirements in Section 15A(b)(6) of the Exchange Act that an association's rules be reasonably designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.

### C. Scope of CAB Permitted Activities

#### 1. Secondary Market Transactions

As initially filed with the Commission, FINRA's definition of a CAB in Rule 016(c) would have included, 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." One commenter interpreted that description as including both primary issuances and secondary transactions in unregistered securities and requested that FINRA confirm the intent to include secondary transactions among the permitted activities of a CAB.<sup>59</sup> Another commenter noted that the definition appears to permit CABs to act as agent in the purchase or sale of debt, equity and equity-linked instruments, and not solely one category of securities.<sup>60</sup> One commenter supported the definition in its original form.<sup>61</sup>

Due to concerns that permitting CABs to act as agent in a wide array of secondary market transactions would be inconsistent with the purpose of its proposed rule set, FINRA subsequently amended proposed CAB Rule 016(c)(1)(F) to narrow the range of permitted secondary market activities.<sup>62</sup>

<sup>59</sup> See New York State Bar Association Letter, *supra* note 6, at 2.

<sup>60</sup> See Q Advisors Letter, *supra* note 6, at 1.

<sup>61</sup> See 3PM Letter, *supra* note 6, at 1–2.

<sup>62</sup> See Notice of Amendment No. 2, *supra* note 9, 81 FR at 44372–44373. Prior to Amendment No. 2, FINRA also amended the scope in Amendment No. 1 to clarify that the definition of "capital acquisition broker" does not include any broker or dealer that effects securities transactions that would

<sup>48</sup> In response to another comment, the Commission notes that FINRA agrees that a CAB that determines to terminate its status as such and revert back to a non-CAB firm should be permitted to continue to operate as a CAB while its CMA or application to amend its membership agreement is pending, barring unusual circumstances.

<sup>49</sup> See New York State Bar Association Letter, *supra* note 6, at 2.

<sup>50</sup> See FINRA Response, *supra* note 11, at 27.

<sup>51</sup> See 3PM, *supra* note 6, at 2 and Roth Letter, *supra* note 6, at 1.

<sup>52</sup> FINRA Rule 1230 requires that each of the following persons be registered with FINRA as an Operations Professional: (i) Senior management with direct responsibility over the covered functions under the Rule; (ii) Any person designated by senior management under the Rule as

As amended, a CAB will be permitted to engage in qualifying, identifying, soliciting, or acting as a placement agent or finder (i) on behalf of an issuer in connection with a sale of newly-issued, unregistered securities to institutional investors or (ii) on behalf of an issuer or a control person in connection with a change of control of a privately-held company.

In response to Amendment No. 2, one commenter states its view that CAB Rule 016(c)(1)(F) should expressly permit CABs to engage in secondary market transactions.<sup>63</sup> The commenter suggests that CABs should be permitted to sell subsequent to a private placement any securities that the CAB receives as compensation for acting as a placement agent in a private placement securities transaction. The commenter also recommends that CABs be permitted to act as agent to assist the owner of securities purchased in a private placement to sell them subsequent to such private placement. The commenter suggests that it is common for placement agents to receive compensation in the form of restricted stock, options or warrants, and for the owner of securities purchased in a private placement to desire sometime later to sell those securities in a private secondary market transaction. The commenter argues that, without its recommended changes, it is likely many firms will decline to elect CAB status due to fears of engaging in impermissible activities.

In response, FINRA states that it does not believe that proposed CAB Rule 016(c)(1)(F) should be amended. FINRA states that other provisions of the proposal that preceded the filing of Amendment No. 2 would prohibit some of the activities that the commenter recommends. FINRA further explains that allowing a CAB to dispose of securities that it receives as compensation for placement agent services would likely be inconsistent with the prohibition on a CAB engaging in proprietary trading, and could be interpreted as allowing trading activities that do not fall within a CAB's business model. FINRA states that the definition of a CAB also prohibits a CAB from holding or handling customer funds or securities. To the extent that a CAB handles a customer's stock certificate as part of its services, a CAB could not act as agent on behalf of an owner who is disposing of privately placed securities.

require the broker or dealer to report the transaction under the FINRA Rules 6300 Series, 6400 Series, 6500 Series, 6600 Series, 6700 Series, 7300 Series or 7400 Series. See Notice of Amendment No. 1, *supra* note 7, 80 FR at 22333.

<sup>63</sup> See SDR Letter, *supra* note 10, at 1.

FINRA states that amending these various provisions to accommodate these activities at this time would not be prudent, particularly given the risk that these amendments would inadvertently allow some firms that do not fall within the intended business model to elect CAB status. FINRA states that it will consider proposed changes to the CAB rules after FINRA and the industry have gained experience with their application to CABs.

## 2. Prohibition on Private Securities Transactions

One commenter objects to CAB Rule 328 (Prohibition on Private Securities Transactions)<sup>64</sup> on the grounds that a CAB should be permitted to set its own policies to supervise private securities transactions.<sup>65</sup> Another commenter suggests that FINRA revise CAB Rule 328 to allow: (1) The investment advisory activities of associated persons of CABs who are also employees or supervised persons of an investment adviser registered with the SEC or a state ("RIA"); and (2) associated persons of CABs to be 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) or Regulation R.<sup>66</sup>

In response, FINRA states that it does not agree that CAB Rule 328 should be revised to allow activities to be engaged in by associated persons in their capacities as RIA or bank employees, nor does it believe CABs should be allowed to supervise private securities transactions as a business decision.<sup>67</sup> FINRA notes that CABs will engage only in a limited range of institutional securities activities, generally involving either advice to companies and issuers regarding private equity or merger and acquisition transactions, or acting as agent on behalf of an issuer in connection with a sale of newly-issued, unregistered securities to institutional investors or on behalf of an issuer or a control person in connection with a change of control of a privately-held company.<sup>68</sup> Given the limited nature of CABs' permissible business activities, FINRA believes that CABs generally will not be well positioned to supervise and keep records of private securities

<sup>64</sup> CAB Rule 328 prohibits persons associated with a CAB from participating in any manner in a private securities transaction as defined in FINRA Rule 3280(e).

<sup>65</sup> See IMS Letter 1, *supra* note 6.

<sup>66</sup> See New York State Bar Association Letter, *supra* note 6, at 3-4.

<sup>67</sup> See FINRA Response, *supra* note 11, at 23.

<sup>68</sup> *Id.*

transactions, particularly if a CAB employee conducted business with retail investors through an RIA or bank. Accordingly, FINRA believes that the prohibitions in Rule 328 should remain as proposed.

## 3. Prohibition on CABs Chaperoning Foreign Broker-Dealers

One commenter suggests that FINRA should allow CABs to chaperone foreign associated persons under Exchange Act Rule 15a-6, since other broker-dealers that are subject to a \$5,000 net capital requirement are permitted to engage in this activity.<sup>69</sup> In response, FINRA states that it does not agree that CABs should be permitted to engage in chaperoning activities under Exchange Act Rule 15a-6.<sup>70</sup> FINRA notes that the CAB rule set did not contemplate that CABs will engage in these activities, and FINRA does not believe that most firms that would consider registering as a CAB currently engage in them. As such, FINRA declines to make this change.

## 4. Permitted Activities With Institutional Investors

One commenter suggests that the definition of a CAB is problematic because it allows CABs to provide services only to institutional investors as defined by the proposal, which it believes is too restrictive.<sup>71</sup> Two commenters also object to the definition of institutional investor because it does not include accredited investors as defined under Securities Act Regulation D.<sup>72</sup> Noting that FINRA had stated it purposefully did not propose to define "institutional investor" to include accredited investors due to serious concerns with the manner in which firms market and sell private placements to accredited investors, one of these commenters recommends that FINRA should address any potential sales practice problems by incorporating any other rules needed for this purpose, rather than prohibiting the solicitation of accredited investors.<sup>73</sup> Another commenter suggests that FINRA consider lowering the threshold for institutional investors preferably to \$5 million or less.<sup>74</sup> This commenter also suggests that many issuers may have less than \$50 million in assets but are otherwise sophisticated, knowledgeable and advised by competent attorneys.<sup>75</sup>

<sup>69</sup> See IMS Letter 1, *supra* note 6, at 3-4.

<sup>70</sup> See FINRA Response, *supra* note 11, at 6.

<sup>71</sup> See IMS Letter 1, *supra* note 6, at 7-8.

<sup>72</sup> See *id.* See also Achates Letter, *supra* note 6 at 1.

<sup>73</sup> See Achates Letter, *supra* note 6, at 1.

<sup>74</sup> See Intellivest Letter, *supra* note 6, at 1.

<sup>75</sup> *Id.*

In addition to institutional investors, one commenter suggests that FINRA permit CAB transactions with certain other categories of persons, specifically: (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.<sup>76</sup> Another commenter also requests a de minimis and/or knowledgeable employee exemption to allow for one-off capital-raises (under various scenarios where accredited individuals working at alternative investment firms and the funds they manage or other closely affiliated individuals desire to invest) without violating the CAB rules.<sup>77</sup> This commenter also states that 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.<sup>78</sup> In addition, the commenter suggests that 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 will not apply.<sup>79</sup>

In response, FINRA states that the term “institutional investor” is relevant only with respect to CAB Rule 016(c)(1)(F), which permits CABs to qualify, identify, solicit or act as placement agent or finder on behalf of an issuer in connection with a sale of newly-issued, unregistered securities to institutional investors or on behalf of an issuer or control person in connection with a change of control of a privately-held company.<sup>80</sup> FINRA notes that CABs may provide a wide array of negotiation, consulting and advisory services to issuers, companies and their owners without regard to whether these parties fall within the definition of institutional investor pursuant to CAB Rule 016(c)(1)(A) through (E).<sup>81</sup> In addition, CABs are permitted to effect securities transactions on behalf of accredited investors that do not meet

the definition of institutional investor in transactions involving the transfer of control of a business or company, as permitted by an SEC rule, release or no-action letter, pursuant to CAB Rule 016(c)(1)(G).<sup>82</sup>

By adding qualified purchasers to the definition of “institutional investor,” FINRA states that its proposal permits CABs to solicit investors that have at least \$5 million in investments pursuant to CAB Rule 016(c)(1)(F).<sup>83</sup> However, FINRA states that it does not believe it is either necessary or appropriate to extend the definition to include accredited investors who have less than \$5 million in investments, since those investors may not have the requisite investment acumen or financial means to understand or assume the risks associated with investments sold by CABs.<sup>84</sup> FINRA believes that the CAB rule set is not an appropriate model for the broader, more retail, private placement marketplace, given that investors in the private placement market have been harmed by widespread fraud and abuse in recent years.<sup>85</sup> In addition, FINRA notes that the SEC is also looking at whether the definition of accredited investor should be revised.<sup>86</sup> Moreover, FINRA states that expanding the definition of “institutional investor” to include accredited investors would be substantially inconsistent with similar definitions of “institutional investor” or

“institutional account” in other FINRA Rules.<sup>87</sup>

For these reasons, FINRA also does not believe it is appropriate at this time to revise the definition of institutional investor to include knowledgeable employees as that term is defined in Investment Company Act Rule 3c-5, as suggested by one commenter.<sup>88</sup> FINRA states that it may consider revising this definition at a later date, depending on the need to expand it, as well as CABs’ investment activities.

FINRA believes that any firm that wishes to engage in private placement activities beyond that contemplated for CABs should be registered as a non-CAB broker-dealer and be subject to all FINRA rules, not just the more limited rule set applicable to CABs.<sup>89</sup> For example, FINRA believes that non-CAB rules that are more oriented to business conducted with retail investors, such as FINRA Rule 2210 (Communications with the Public) should apply to these types of private placement firms, rather than the CAB rules.

The Commission believes that it is reasonable and consistent with the protection of investors and the public interest for FINRA to limit the permitted activities of CABs in the manner discussed above, given the stated purpose of its proposal and the limited rule set that is applicable to CABs. Specifically, FINRA states in the Notice of Filing that it is proposing a separate rule set that would apply to firms that it describes as those that are “solely corporate financing firms that advise companies on mergers and acquisitions, advise issuers on raising debt and equity capital in private placements with institutional investors, or provide advisory services on a consulting basis to companies that need assistance analyzing their strategic and financial alternatives.”<sup>90</sup> In this context, FINRA’s CAB rules, which are more streamlined than the full FINRA rule set, are designed to provide appropriate flexibility and investor protection in the context of a CAB’s limited permissible activities.

#### D. Conduct Rules

As detailed above in Section II.C., the CAB rule set imposes a streamlined set of conduct rules on CABs. One such rule, CAB Rule 209, states in part that a CAB must use reasonable diligence to know and retain the essential facts concerning a customer.<sup>91</sup> The facts

<sup>82</sup> *Id.*

<sup>83</sup> See *id.* at 10–11 and Investment Company Act of 1940 § 2(a)(51) (“Investment Company Act”).

<sup>84</sup> See FINRA Response, *supra* note 11, at 10–11.

<sup>85</sup> FINRA states that it has many formal investigations involving broker-dealer conduct in private placements. In 2015, FINRA conducted over 650 reviews involving private placements from sources including customer complaints, tips, referrals, and firm filings. FINRA states that approximately 100 of these matters are currently open and under review, and that it has recently settled many cases regarding private placements. FINRA states that it has brought multiple cases against firms that participated in these offerings and their relevant employees. Further, FINRA also states that state securities regulators also are bringing many enforcement cases involving private placements. FINRA notes that NASAA reported that in 2014, Regulation D offerings were the second most frequently investigated matters as reported by states. In addition, FINRA states that the SEC has settled cases involving fraud or abuse in the private placement market. FINRA states, for example, that in July 2009, the SEC brought actions involving two high-profile private placements, Medical Capital Holdings Inc. and Provident Royalties LLC. *SEC v. Provident Royalties, LLC.*, SEC Litigation Release No. 21118, 2009 SEC LEXIS 2241 (July 7, 2009); *SEC v. Medical Capital Holdings, Inc.*, SEC Litigation Release No. 21141, 2009 SEC LEXIS 2390 (July 20, 2009). See FINRA Response, *supra* note 11, at 11–12.

<sup>86</sup> See U.S. Securities and Exchange Commission, Report on the Review of the Definition of “Accredited Investor” (December 18, 2015), available at [www.sec.gov](http://www.sec.gov).

<sup>87</sup> See, e.g., FINRA Rules 2210(a)(4) and 4512(c).

<sup>88</sup> See FINRA Response, *supra* note 11, at 12.

<sup>89</sup> *Id.* at 12–13.

<sup>90</sup> Notice of Filing, *supra* note 3, 80 FR at 79969.

<sup>91</sup> See FINRA Response, *supra* note 11, at 16–17.

<sup>76</sup> See New York State Bar Association Letter, *supra* note 6, at 3–4.

<sup>77</sup> See Coronado Letter, *supra* note 6, at 1.

<sup>78</sup> *Id.*

<sup>79</sup> *Id.*

<sup>80</sup> See FINRA Response, *supra* note 11, at 7.

<sup>81</sup> *Id.* at 10.

essential to knowing the customer include those required to effectively service the customer's account and understand the authority of each person acting on behalf of the customer. With respect to this CAB rule, one commenter requests clarification of FINRA's statement that "[i]t also recognizes that a CAB or its associated person may look to an institutional investor's agent if the investor is represented by an agent."<sup>92</sup> Specifically, this commenter requests clarification as to what "look to" requires and whether this can be interpreted to mean that a CAB's responsibility under CAB Rule 209 is limited to learning the essential facts of the agent.<sup>93</sup> Another commenter also seeks clarification as to whether a CAB's responsibility under CAB Rule 209 is limited to learning the essential facts of the agent.<sup>94</sup>

In response, FINRA states that it recognizes that firms that elect CAB status often will be dealing with customers that are represented by agents, and that CAB Rule 209 contemplates situations in which a customer is represented by an agent.<sup>95</sup> For example, CAB Rule 209 states in part that the facts essential to knowing the customer are those required to effectively service the customer's account and understand the authority of each person acting on behalf of a customer.<sup>96</sup> FINRA also states that the type of information necessary to satisfy the requirements of CAB Rule 209 will depend on the facts and circumstances. FINRA explains that the FINRA Rule 2090 "know your customer" obligation is flexible and that the extent of the obligation generally should depend on a particular firm's business model, its customers, and applicable regulations,<sup>97</sup> and that this same flexibility applies to CAB Rule 209, which is modeled on FINRA Rule 2090. Furthermore, FINRA notes that although a CAB must understand, *inter alia*, the essential facts about a customer that are necessary to effectively service the customer's account and the authority of each person acting on behalf of the customer, the rule does not prescribe the exact information that should be assessed or the process by which it should be obtained. Depending on the facts and circumstances, FINRA states that a CAB could comply with CAB Rule 209 by reasonably relying on the assistance of

a customer's agent in obtaining the essential facts about the customer.<sup>98</sup>

CAB Rule 211 states that a CAB or an associated person of a CAB must have a reasonable basis to believe that a recommended transaction or investment strategy (as defined in FINRA Rule 2111) involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the broker or associated person to ascertain the customer's investment profile. CAB Rule 211 specifies that a CAB or associated person fulfills this customer-specific suitability obligation for an institutional investor, if: (1) The broker or associated person has a reasonable basis to believe that the institutional investor is capable of evaluating investment risks independently, both in general and with regard to particular transactions and investment strategies involving a security or securities; and (2) the institutional investor affirmatively indicates that it is exercising independent judgment in evaluating the broker's or associated person's recommendations. CAB Rule 211 also states in part that, where an institutional investor has delegated decision-making authority to an agent, such as an investment adviser or a bank trust department, the factors in determining whether a CAB has a reasonable basis to believe that the institutional investor is capable of evaluating investment risks independently and indicates that it is exercising independent judgment apply to the agent rather than to the investor.

One commenter generally agrees with CAB Rule 211, but believes that the rule fails by requiring the suitability analyses to be performed before any recommendation is made.<sup>99</sup> The commenter believes that the rule does not recognize that the process of diligence is ongoing, in many cases can take several months to several years before an investment decision is made, and often does not, and should not conclude until the deal is closed. The commenter believes that Rule 211 should emphasize this point and encourage registered representatives to periodically review their suitability analysis throughout the offering process, but no less frequently than once before the subscription agreement or relevant contract is signed and due diligence is as complete as it can be at that particular time.<sup>100</sup> In response, FINRA states that FINRA Rule 2111 applies the suitability rule on a recommendation-

by-recommendation basis. FINRA explains that it is important to emphasize that the rule's focus is on whether the recommendation was suitable when it was made.<sup>101</sup> A recommendation to hold securities, maintain an investment strategy involving securities or use another investment strategy involving securities—as with a recommendation to purchase, sell or exchange securities—normally would not create an ongoing duty to monitor and make subsequent recommendations. Likewise, CAB Rule 211 would not create an ongoing duty to monitor and make subsequent recommendations.<sup>102</sup>

Two commenters request that FINRA clarify what it meant when it said that a CAB may look to an institutional investor's agent for suitability.<sup>103</sup> One of those commenters suggests that FINRA should recognize that a CAB may not have access to some information about an investor, particularly where the investor is represented by an agent. As an example, the commenter posits that a CAB may have little information about an investor's overall investment portfolio. The commenter requests that FINRA clarify how CAB Rule 211 would apply in these circumstances. In particular, the commenter recommends that the proposed rules address some type of minimum compliance standards that would be appropriate to these situations, and that a demonstrable best efforts basis may be a satisfactory alternative in such instances.<sup>104</sup>

As noted, FINRA recognizes that CABs often will be dealing with customers represented by agents, and CAB Rule 211 contemplates such situations. FINRA emphasizes that CAB Rule 211 states in part that, where an institutional investor has delegated decision-making authority to an agent, such as an investment adviser or a bank trust department, the factors in determining whether a CAB has a reasonable basis to believe that the institutional investor is capable of evaluating investment risks independently and indicates that it is exercising independent judgment apply to the agent rather than to the investor.<sup>105</sup> Thus, FINRA does not believe it would be appropriate to suggest minimum compliance standards in situations in which a CAB may have limited information about a

<sup>92</sup> See 3PM Letter, *supra* note 6, at 2–3.

<sup>93</sup> *Id.*

<sup>94</sup> See Roth Letter, *supra* note 6, at 1–2.

<sup>95</sup> See FINRA Response, *supra* note 11, at 17.

<sup>96</sup> *Id.* at 17–18.

<sup>97</sup> See Exchange Act Release No. 62718 (Aug. 13, 2010), 75 FR 52562 (Aug. 26, 2010) (Notice of Filing of File No. SR-FINRA-2010-039).

<sup>98</sup> See FINRA Response, *supra* note 11, at 18.

<sup>99</sup> See 3PM Letter, *supra* note 6, at 3.

<sup>100</sup> *Id.*

<sup>101</sup> See FINRA Response, *supra* note 11, at 18.

<sup>102</sup> *Id.*

<sup>103</sup> See Roth Letter, *supra* note 6, at 1 and 3PM Letter, *supra* note 6, at 3.

<sup>104</sup> See 3PM Letter, *supra* note 6, at 3.

<sup>105</sup> See FINRA Response, *supra* note 11, at 18.

customer.<sup>106</sup> FINRA states that determining the “essential facts” needed to effectively service a customer’s account and the information necessary to form a reasonable basis to believe that a recommendation is suitable for a non-institutional customer or that an institutional customer (or its agent) is capable of evaluating investment risks independently will always vary depending on the facts and circumstances.

FINRA’s CAB rules do not apply FINRA Rules 2121 (Fair Prices and Commissions), 2122 (Charges for Services Performed), and 2124 (Net Transactions with Customers) to CABs. FINRA does state, however, that depending on the facts, CAB Rule 201 (Standards of Commercial Honor and Principles of Trade) may apply in situations in which a CAB charged a commission or fee that clearly is unreasonable under the circumstances. One commenter states its view that applying CAB Rule 201, which is modeled on FINRA Rule 2010, may lead to interpretive issues when a CAB charges a commission or fee that clearly is unreasonable under the circumstances.<sup>107</sup> In response, FINRA states that it does not agree that the CAB rule set will create an interpretive issue in situations where a CAB charges unreasonable commissions.<sup>108</sup> Specifically, FINRA explains that it will apply the principles of CAB Rule 201 in the same manner as it currently interprets FINRA Rule 2010. Should interpretive issues arise with regard to the application of CAB Rule 201 to CAB commissions or fees, FINRA is open to further discussion of any specific interpretive issues should the context arise, and would consider whether any further rulemaking in this area is necessary.<sup>109</sup>

The Commission believes that the CAB conduct rules are consistent with Section 15A(b)(6) of the Exchange Act in that they are reasonably designed to take into account the limited permissible activities of CABs, while still addressing the protection of investors and the public interest. The Commission also believes that FINRA has appropriately responded to comments regarding the proposed CAB conduct rules to clarify their scope and purpose. In this regard, we note that FINRA indicates that, depending on the facts, CAB Rule 201 (Standards of Commercial Honor and Principles of

Trade) may apply in situations in which a CAB charges a commission or fee that clearly is unreasonable under the circumstances. We also note that FINRA clarifies that a CAB could comply with CAB Rule 209 (Know Your Customer) by reasonably relying on the assistance of a customer’s agent in obtaining the essential facts about the customer, and that CAB Rule 211 (Suitability) contemplates situations where a CAB will be dealing with customers represented by agents for which such suitability determinations will vary depending on the facts and circumstances.

#### *E. Supervisory Procedures and Cybersecurity*

As detailed above in Section II.D., the CAB Rule 300 Series establishes a limited set of supervisory rules for CABs. FINRA states that the CAB supervisory rules are designed to streamline the requirements applicable to CABs where doing so does not hinder investor protection, and that doing so will provide flexibility to CABs to tailor their supervisory structure to their business model, which is limited in scope of permissible activities.<sup>110</sup>

One commenter states its view that requirements related to supervisory procedures for supervisors should not be required for CABs.<sup>111</sup> This commenter also recommends that FINRA clarify its expectations with respect to email review.<sup>112</sup> Specifically, the commenter suggests that the rules should note that expectations for email review should be tailored according to the CAB’s business and that such expectations will not be as stringent as those for broker-dealers engaged in non-CAB activities.<sup>113</sup> In response, FINRA states that CAB Rule 311 incorporates by reference FINRA Rule 3110(b)(4), which requires members to adopt procedures for the review of incoming and outgoing written (including electronic) correspondence and internal communications relating to a member’s investment banking business.<sup>114</sup> FINRA states that the supervisory procedures must be appropriate for the member’s business, size, structure and customers.<sup>115</sup> FINRA believes that these standards offer the flexibility that the commenter seeks, since they recognize that the procedures may be tailored

based on a firm’s business, size, structure and customers.<sup>116</sup>

Also as discussed above in Section II.E, FINRA has not applied FINRA Rule 4370, which requires FINRA members to maintain a business continuity plan, to CABs. One commenter recommends that FINRA clarify the expectations of CABs with respect to cybersecurity.<sup>117</sup> Specifically, while the proposal suggests that a CAB would not be required to have a business continuity plan, the commenter suggests that the final rules include a requirement to have appropriate cybersecurity/information security programs in place, tailored to the CAB’s business.<sup>118</sup> In response, FINRA states that it is not applying the business continuity plan requirements of FINRA Rule 4370, given that, among other things, a CAB may not hold, manage, possess, or otherwise handle customer funds or securities. FINRA, however, recognizes that CABs are broker-dealers, and FINRA states that it will monitor, as part of FINRA’s examination and surveillance process, the development and operation of CABs’ business to identify emergency or business disruptions at CABs that affect the ability of the members to meet their existing obligations to investors and issuers. FINRA will use these efforts to assist in assessing whether additional rulemaking in this area is required.<sup>119</sup> Likewise, FINRA will examine a CAB’s operations to determine compliance with all applicable SEC rules.<sup>120</sup>

The Commission believes that CAB rules are reasonably designed to provide flexibility to CABs to structure their business, including their supervisory and cybersecurity policies and procedures, while providing for

<sup>116</sup> One commenter requests that the SEC work with the appropriate authorities to revisit the anti-money laundering responsibilities of CABs and consider requiring other U.S. registered entities (such as registered investment advisers) to share certain data with FINRA member firms so that all registered participants may satisfy their respective compliance obligations in the most complete and accurate manner possible. In addition, this commenter seeks clarification as to whether CABs, as registered broker-dealers, may rely on previous SEC staff anti-money laundering guidance. See 3PM Letter, *supra* note 6.

In response, FINRA states that because the Bank Secrecy Act imposes AML obligations on all broker-dealers, FINRA does not believe it has the authority to exempt CABs from the requirements to adopt and implement an AML program. To the extent commenters are making suggestions directly to the SEC staff, FINRA states that it is willing to work with the Commission staff if asked. The Commission also notes that CABs, as registered broker-dealers, may rely on previous SEC staff guidance, if applicable to their anti-money laundering requirements and activities.

<sup>117</sup> See Foreside Letter, *supra* note 6, at 1.

<sup>118</sup> *Id.*

<sup>119</sup> See FINRA Response, *supra* note 11, at 20–21.

<sup>120</sup> *Id.*

<sup>110</sup> *Id.* at 20.

<sup>111</sup> See Foreside Letter, *supra* note 6, at 1.

<sup>112</sup> *Id.*

<sup>113</sup> *Id.*

<sup>114</sup> See FINRA Response, *supra* note 11, at 20.

<sup>115</sup> *Id.*

<sup>106</sup> *Id.*

<sup>107</sup> See IMS Letter 1, *supra* note 6, at 12 and IMS Letter 2, *supra* note 6, at 4–6.

<sup>108</sup> See FINRA Response, *supra* note 11, at 16.

<sup>109</sup> *Id.*

protection of investors and the public interest, in the context of the limited permitted activities of CABs. Although FINRA is providing flexibility to CABs, we note that FINRA states that a CAB's supervisory procedures must be appropriate for the member's business, size, structure and customers, and that FINRA will monitor, as part of its examination and surveillance process, the development and operation of CABs' business to identify emergency or business disruptions at CABs that affect the ability of the members to meet their existing obligations to investors and issuers. Accordingly, the Commission believes that the proposed rule change is reasonably designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest consistent with Section 15A(b)(6) of the Exchange Act.

#### IV. Conclusion

For the reasons discussed above, the Commission finds that the rule change, as modified by Amendment Nos. 1 and 2, is consistent with the Exchange Act and the rules and regulations thereunder, in particular with Section 15A(b)(6) of the Exchange Act, which requires in part that FINRA's rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.<sup>121</sup>

*It Is Therefore Ordered*, pursuant to Section 19(b)(2) of the Act,<sup>122</sup> that the rule change, SR-FINRA-2015-054, as modified by Amendment Nos. 1 and 2, be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>123</sup>

**Robert Errett,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-78610; File No. SR-NYSEArca-2016-82]

### Self-Regulatory Organizations; NYSE Arca, Inc.; Notice of Designation of a Longer Period for Commission Action on a Proposed Rule Change To List and Trade Shares of the JPMorgan Diversified Event Driven ETF Under NYSE Arca Equities Rule 8.600

August 18, 2016.

On June 20, 2016, NYSE Arca, Inc. filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to list and trade shares of the JPMorgan Diversified Event Driven ETF under NYSE Arca Equities Rule 8.600. The proposed rule change was published for comment in the **Federal Register** on July 7, 2016.<sup>3</sup> The Commission received no comment letters on the proposed rule change.

Section 19(b)(2) of the Act<sup>4</sup> provides that, within 45 days of the publication of notice of the filing of a proposed rule change, or within such longer period up to 90 days as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or as to which the self-regulatory organization consents, the Commission shall either approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether the proposed rule change should be disapproved. The 45th day after publication of the notice for this proposed rule change is August 21, 2016. The Commission is extending this 45-day time period.

The Commission finds that it is appropriate to designate a longer period within which to take action on the proposed rule change so that it has sufficient time to consider the proposed rule change. Accordingly, the Commission, pursuant to Section 19(b)(2) of the Act,<sup>5</sup> designates October 5, 2016, as the date by which the Commission should either approve or disapprove or institute proceedings to determine whether to disapprove the proposed rule change (File Number SR-NYSEArca-2016-82).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release No. 78218 (Jul. 1, 2016), 81 FR 44339.

<sup>4</sup> 15 U.S.C. 78s(b)(2).

<sup>5</sup> *Id.*

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>6</sup>

**Robert W. Errett,**

*Deputy Secretary.*

[FR Doc. 2016-20204 Filed 8-23-16; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-78611; File No. SR-MSRB-2016-07]

### Self-Regulatory Organizations; Municipal Securities Rulemaking Board; Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 1, Consisting of Proposed Amendments to Rule G-12, on Uniform Practice, Regarding Close-Out Procedures for Municipal Securities

August 18, 2016.

#### I. Introduction

On May 11, 2016, the Municipal Securities Rulemaking Board (the "MSRB" or "Board") filed with the Securities and Exchange Commission (the "SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change consisting of proposed amendments to Rule G-12, on uniform practice, regarding close-out procedures for municipal securities. The proposed rule change was published for comment in the **Federal Register** on June 1, 2016.<sup>3</sup>

The Commission received three comment letters on the proposal.<sup>4</sup> On July 25, 2016, the MSRB responded to the comments<sup>5</sup> and filed Amendment No. 1 to the proposed rule change.<sup>6</sup> The

<sup>6</sup> 17 CFR 200.30-3(a)(31).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> Securities Exchange Act Release No. 77903 (May 25, 2016) (the "Proposing Release"), 81 FR 35111 (June 1, 2016).

<sup>4</sup> See Letters to Secretary, Commission, from Leslie M. Norwood, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association ("SIFMA"), dated June 22, 2016 (the "SIFMA Letter"); Michael Nicholas, Chief Executive Officer, Bond Dealers of America ("BDA"), dated June 22, 2016 (the "BDA Letter"); and David T. Bellaire, Esq., Executive Vice president and General Counsel, Financial Services Institute ("FSI"), dated June 22, 2016 (the "FSI Letter").

<sup>5</sup> See Letter to Secretary, Commission, from Michael Cowart, Deputy Director, Professional Qualifications and Assistant General Counsel, MSRB, dated July 25, 2016 (the "MSRB Response and Amendment Letter"), available at <https://www.sec.gov/comments/sr-msrb-2016-07/msrb201607-4.pdf>.

<sup>6</sup> *Id.* In Amendment No. 1, the MSRB partially amended the text of the original proposed rule

<sup>121</sup> See 15 U.S.C. 78o-3(b)(6).

<sup>122</sup> 15 U.S.C. 78s(b)(2).

<sup>123</sup> 17 CFR 200.30-3(a)(12).