



Newly Created “Capital Acquisition Broker” Rule Reduces Regulatory Burdens on Some Broker-Dealers

On August 18th, the Securities and Exchange Commission (“SEC”) approved a Financial Industry Regulatory Authority Inc. (“FINRA”) rule that establishes less burdensome regulations for “Capital Acquisition Brokers” (“CABs”), which are a subclass of broker-dealers that engage only in limited activities. CABs can elect to be governed by the new rules by converting their current FINRA membership or by submitting a new membership application.

Under the new rule, a CAB is defined as any broker engaging solely in at least one 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;
- Providing fairness opinions, valuation services, expert testimony, litigation support, and negotiation and structuring services;
- Assisting in the preparation of offering materials on behalf of an issuer;
- Qualifying, identifying, soliciting, or acting as a placement agent or finder:
 - on behalf of an issuer in connection with a sale of newly-issued, unregistered securities to institutional investors (which includes banks, insurance companies, registered investment companies, governmental entities, any person with assets of at least \$50 million, and “qualified purchasers” as defined in Section 2(a)(51) of the Investment Company Act of 1940), or
 - on behalf of an issuer or control person in connection with a change of control of a privately-held company; and
- Effecting securities transactions solely in connection with the transfer of ownership and control of a privately held company consistent with the limitations in the [SEC’s 2014 M&A Broker no-action letter](#).

FINRA expressly excludes from the definition of a CAB any broker 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 otherwise permitted by CAB rules);
- 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.

The new rules require CABs to comply with many of the same rules as non-CAB broker-dealers, including (i) having registered personnel who have qualified through FINRA exams; (ii) maintaining minimum net capital requirements; (iii) filing quarterly FOCUS reports; (iv) undergoing annual audits; (v) maintaining Securities Investor Protection Corporation membership; (vi) undergoing or subjecting



themselves to FINRA exams, investigations, and arbitration; (vii) maintaining certain written supervisory procedures; and (viii) establishing policies requiring an independent anti-money laundering review every two years.

CAB registrants can streamline their filing process and are subject to fewer compliance requirements than standard broker-dealers. Unlike non-CAB broker-dealers, CABs will not be required to file advertising materials, perform annual compliance meetings, or obtain annual CEO Certifications.

Although the new CAB rules will help some funds spend less on compliance and streamline their advisory roles, CAB status limits other fundraising activities. These restrictions might overshadow the benefits for smaller funds. For instance, the CAB rules will not allow a fund sponsor registered as a CAB to engage in any broker-dealer activities with respect to sponsors marketing 3(c)(7) funds. Additionally, the CAB rules prohibit a CAB's associated person from engaging in private securities transactions. Fund sponsors who need to engage in such transactions (such as selling securities separate from the CAB) would not be allowed to do so and keep their registration status. CABs also cannot raise capital from accredited investors unless they are also qualified purchasers. Small funds in which the managers occupy different roles might find too many conflicts with CAB regulations for this to be a feasible type of broker registration. Nonetheless, this new registration option may prove useful for funds that need to engage in some broker-dealer activities but do not manage customer funds.