INTEGRATED SOLUTIONS℠

April 8, 2016

Via email only: rule-comments@sec.gov

RE: SR-FINRA-2015-054
Proposed Rule Change to Adopt the Capital Acquisition Broker Rules

The SEC and FINRA have submitted for comment various iterations of a Proposed Rule Change (the "Proposal") to Adopt the Capital Acquisition Broker Rules ("CAB").[1] As part of that process, the SEC recently instituted proceedings to determine whether the Proposal should be approved and has specifically asked for comment on whether CABs should be subject to a separate rule set as well as the FINRA By-Laws and "…core FINRA rules that FINRA believes should apply to all firms" (collectively, the "CAB Rules").[2]

Integrated Solutions ("IS") is one of the largest providers of compliance consulting and financial accounting services to the financial services industry, including to about 100 FINRA members, among others types of financial services firms.[3] We counsel clients daily on the scope of permissible broker-dealer activities under various FINRA, SEC and other rules. At any one time, we have several New Member Applications, Continuing Membership Applications and

[1] The issues related to carving out FINRA membership exceptions for non-custodial brokers raised by the Proposal have a long history. Initially, FINRA proposed establishing a category of membership for "Limited Corporate Finance Brokers" ("LCFB"); RN 14-09. That evolved into the Proposed Rule Change to Adopt the Capital Acquisition Broker Rules ("CAB") (SR-FINRA-2015-054) for which the SEC has instituted these proceedings. In addition, the SEC also issued the Six Lawyers No-Action Letter regarding the exception for merger and acquisition brokers (the "Six Lawyers Letter"), SEC No-Action Letter, dated Jan. 31, 2014, revised February 4, 2014; available at: http://www.sec.gov/divisions/marketreg/mr-noaction/2014/ma-brokers-013114.pdf. The option for non-FINRA registered firms and individuals under the Six Lawyers Letter to engage in merger and acquisition activities is a viable alternative to the CAB Proposal, depending on the nature of the activities and authorized customers such a firm and/or individual targets. We note that the Six Lawyers Letter largely incorporates a proposal first made in 2005 (after many years of study) by the Task Force of the American Bar Association's Section of Business Law on Private Placement Broker Dealers ("ABA Task Force Report"). 60 Bus. Law. 959 (2005) or http://www.sec.gov/rules/other/265-23/gvniesar091205.pdf.

[2] SEC Rel. No. 34-77391; File No. SR-FINRA-2015-054, p.3. This issue has been part of the FINRA proposals for both LCFBs and CABs.

[3] The statements in this comment letter incorporate the views of IS, not those of our clients.

Materiality Consultations submitted to FINRA on behalf of clients. IS has regular, daily experience with FINRA's membership categories and rules, the SEC and other regulators with jurisdiction over the financial services industry. We counsel clients in the financial reporting and compliance requirements applicable to broker-dealers, and how they are, in fact, implemented by the various regulators. Our clients have also asked for advice on whether they could (and should) operate lawfully under the parameters of the SEC's M&A Brokers No-Action Letter (the "Six Lawyers Letter").[4] We believe this experience enables us to assess the impact of the CAB Proposal on current and future FINRA members from both a regulatory and business perspective.

IS has commented negatively on the prior iterations of the CAB Proposal for a multiplicity of reasons based on substantive, risk management, policy-making and business operational concerns.[5] FINRA remains determined to implement the CAB Proposal at all costs. We recognize that much thought and a great many hours have gone into finalizing the CAB Proposal. Nonetheless, among many other concerns, we remain convinced that issuing a separate rule set, currently consisting of approximately 50 distinct rules (although many simply refer to a specific FINRA Rule[6]), will not prove helpful either to CABs or FINRA. We also think they violate (often flagrantly) the SEC's "Plain English" mandate.[7]

[4] SEC No-Action Letter, dated Jan. 31, 2014, revised February 4, 2014; available at: http://www.sec.gov/divisions/marketreg/mr-noaction/2014/ma-brokers-013114.pdf. We believe that this CAB Proposal is FINRA's response to the Six Lawyers Letter so as to keep more business activities within the FINRA regulatory umbrella.

[5] Many of our prior objections to both the LCFB and CAB proposals, and those of at least 65 other commenters, were essentially ignored by FINRA in this CAB Proposal.

[6] These are often not helpful. For example, CAB Rule 015, "Application of Rules to Municipal Securities," simply states that "FINRA Rule 0150 shall apply to the Capital Acquisition Broker Rules." SR-FINRA-2015-054, pp. 282. That particular FINRA Rule defines (by reference to the Exchange Act) what are "exempted securities" and "municipal Securities" (FINRA Rule 0150(a)), provides a long list of citations to the FINRA rules applicable to exempted securities (FINRA Rule 0150(c)) and explicitly excludes transactions in municipal securities (FINRA Rule 0150). Since CABs are excluded from any transactions in municipal securities and highly unlikely to deal in exempted securities, this CAB Rule makes no sense. If, somehow, a CAB engages in a transaction involving an exempted security, surely there is a more direct way, consistent with the Plain English rules and the Plain Writing Act, to state the applicable requirements a CAB is expected to meet.

[7] Discussed further in this comment letter, below.

The CAB Rules are Duplicative, Unnecessary and Confusing

The very first rule in the proposed separate rule set, CAB Rule 014, is ambiguous, creates interpretive difficulties and does not provide an auspicious incentive to adopt a separate rule set.

> **014. Application of the By-Laws and the Capital Acquisition Broker Rules[8]**
>
> All persons that have been approved for membership in FINRA as a capital acquisition broker and persons associated with capital acquisition brokers shall be subject to the FINRA By-Laws (including the schedules thereto), unless the context requires otherwise, and the Capital Acquisition Broker Rules. Persons associated with a capital acquisition broker shall have the same duties and obligations as a capital acquisition broker under the Capital Acquisition Broker Rules.[9]
>
> The terms used in the Capital Acquisition Broker Rules, if defined in the FINRA By-Laws, shall have the meaning as defined in the FINRA By-Laws, unless a term is defined differently in a Capital Acquisition Broker Rule, or unless the context of the term within a Capital Acquisition Broker Rule requires a different meaning. (Emphasis added.)

There is no guidance as to what "context" may "require otherwise" and when and under what circumstances. First, you are forced to consult the CAB Rule definitions (not necessarily a bad thing) to determine if a CAB Rule definition exists. Now, comes the hard part. The language of the Rule itself sets up an interpretive nightmare. It recognizes that there may be a definitional inconsistency between a CAB Rule definition and one contained in the FINRA By-Laws – not at all helpful. But, even worse, not only is the CAB Rule not given primacy, "…the context of the term within a Capital Acquisition Broker Rule [may] require[] a different meaning." From a counseling perspective, these interpretive options make it impossible to advise a client as to what the actual definition is and, more significantly, whether it applies in a particular context. If this inherent confusion occurs in a definition, then any CAB Rule that uses that particular term is likewise compromised.

[8] SR-FINRA-2015-054, pp. 281-82.

[9] We believe this last sentence merely repeats the rule stated in the first sentence since the first sentence explicitly includes "persons associated with capital acquisition brokers."

In 1998, the SEC's Office of Investor Education and Advocacy first issued A Plain English Handbook.[10] The Plain Writing Act of 2010 (the "Plain Writing Act") was enacted to make it easy for the public to understand government documents. It defines "plain writing" as writing that is "clear, concise, well-organized, and follows other best practices appropriate to the subject or field or audience." Moreover, Federal Plain Language Guidelines were issued to implement the Plain Writing Act.[11] There is nothing in CAB Rule 014 that meets the guidelines and specific rules of either A Plain English Handbook or the Federal Plain Language Guidelines. Most of the CAB Rules, in fact, violate the Plain English mandate.

To justify a purportedly streamlined separate set of CAB Rules, FINRA has defined what it characterizes as "core FINRA Rules" to which all CABs must adhere. A critical rule for any type of broker-dealer activity is suitability; in fact, it is the crux by which broker-dealer business conduct is measured and certainly qualifies as a "core" FINRA rule. CAB customers may only be institutional investors, a term that has been expanded, for CAB purposes, to include "qualified purchasers" as defined in Section 2(a)(51) of the Investment Company Act of 1940.[12] The clearest and simplest way of mandating that CABs undertake a suitability analysis before making a recommendation would have been to simply classify it as a "core" FINRA rule. Instead, there is a separate rule that, as a matter of substance, essentially tracks FINRA Rule 2111[13]. But CAB Rule 211 explicitly refers to the core FINRA Rule 2111 for a key definition, adding an extra (and time-consuming) layer of analysis. Why do two sets of rules have to be consulted to make a suitability determination? This renders the proposed CAB rule concerning suitability not only confusing but clumsy.[14]

Regrettably, the deferral to "core FINRA Rules" has made many of the CAB Rules confusing and unclear. For example, the Proposal seeks to clarify that CABs and their associated persons can only act as agents on behalf of their clients in very limited circumstances. That is a

[10] Available at the SEC's web site at www.sec.gov/news/extra/handbook.htm.
[11] In fact, the SEC has placed on its website both its plan and ongoing compliance report for implementing the Plain Writing Act. Further, the SEC has requested public input: "We would appreciate the public's help to assess our progress on plain writing. If you have comments or suggestions about our implementation plan, or have difficulty understanding our documents or the pages on our website, please contact us at PlainWriting@sec.gov. https://www.sec.gov/plainwriting.shtml.
[12] CAB Rule 016(i).
[13] The changes are cosmetic, such as replacing the term "member" with "capital acquisition broker." Id.
[14] It also violates the Plain English mandate.

clear rule, but it is also an obvious restriction on CAB activities understandable simply by reading CAB Rule 016(c)(1), which defines what CABs are, and the less clear CAB Rule 016(c)(2), which labels activities prohibited to CABs. However, in its efforts to bolster what it characterizes as "core FINRA Rules," FINRA tortuously parses FINRA 2121, governing fair prices and commissions that members can charge their customers.

> CABs would not be permitted to act as a principal in a securities transaction. Accordingly, the provisions of FINRA 2121 that govern principal transactions do not apply to CAB permitted activities.

> CABs would be permitted [to] [sic] act as agent in a securities transaction only in very narrow circumstances. CABs would be allowed to act as an agent with respect to institutional investors in connection with purchases or sales of unregistered securities. CABs also would be 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.[15]

If the definition of "CAB" provides the same rule, and result, why place an added burden of consulting the "core FINRA Rules" and forcing a compliance or legal advisor to a CAB to figure out which part of which rule (CAB or core?) applies and when? Moreover, does this comport to the Plain English mandate?

Many CAB Rules simply restate long-standing FINRA Rules, policies and practices. For example, in stating that CABs are subject to enforcement actions for misconduct, FINRA provides the following explanation:

> Under proposed CAB Rule 240, if a CAB or associated person of a CAB had engaged in activities that would 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 or

[15] SEC Rel. No. 34-77391; File No. SR-FINRA-2015-054, p.10.

> associated person, including any rule that applies to a FINRA broker- dealer that is not a CAB or to an associated person who is not a person associated with a CAB.[16]

From its earliest days, the SEC has always had the power and authority to bring actions against unregistered persons selling securities or those who violate laws and rules when selling securities. FINRA has always had the power and authority to enforce its conduct rules. Is a separate rule book needed to confirm the obvious?

The CAB Rules also impose restrictions on conduct by associated persons that is permissible under FINRA Rules, with supervisory controls. For inexplicable reasons, instead of letting a CAB firm set its own policies as to whether such activities can be effectively monitored and controlled, the CAB Rules simply contain an outright prohibition[17]. These activities neither thwart the policies nor risk management objectives of FINRA, nor do they go beyond the scope of permissible activities for CABs and their associated persons under CAB Rule 016. For a CAB, this should be a business decision, if it is willing to accept the compliance burden.

> Proposed Rule 328 would prohibit any person associated with a CAB from participating in any manner in a private securities transaction as defined in FINRA Rule 3280(e). [ftn. omitted.] 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 limited business model. This restriction would 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.[18]

Alternatives

A. A Separate Rule Book for CABs

[16] Id., p. 9.
[17] Except for personal investments; see, the last sentence. SEC Rel. No. 34-77391; File No. SR-FINRA-2015-054, p.15. Allowing personal securities transactions still imposes a compliance burden on a firm to verify whether such transaction, in fact, qualifies for the exception.
[18] Id.

If FINRA insists on requiring a separate rule book for CAB activities, it should clearly establish CAB Rules that incorporate the FINRA By-Laws and the core FINRA Rules. Forcing firms to consult three sources is confusing, time-consuming and, as some of the examples we provided above demonstrate, will lead to interpretive issues. In fact, if this alternative is nonetheless approved by the SEC, what FINRA should do is issue a Written Supervisory Procedures template solely for CABs.

There are many problems with this approach, whether there is one, separate "complete" set of CAB Rules or incorporation by reference of the FINRA By-Laws and the core FINRA Rules. One obvious problem is the ongoing issuance by FINRA of rules in the ordinary course. Each time a new rule is issued, FINRA will have to flag whether it applies to CABs. That makes rules unnecessary complicated and longer. It will also likely make the rule issuance process more cumbersome and lengthy.

Wrapping one set of rules around another set of rules is never seamless. Firms want to comply with regulatory rules; it's simply good business practice and makes regulatory reviews quicker and smoother. But forcing firms to consult multiple sources of compliance rules is onerous and time-consuming and a compliance officer may not always remember that an additional source needs to be consulted. Some compliance decisions have to be made "on-the-spot." Fumbling through three sets of sources is monumentally inefficient and once you find the ostensibly applicable rules, you have to reconcile them. One only has to look at what is going on with the joint regulatory notices of the Municipal Securities Rulemaking Board ("MSRB") and FINRA to see that two sets of rules do not always mesh easily. Among our clients, firms subject to both the MSRB and FINRA Rules find the two rulebook approach needlessly burdensome and sometimes difficult to implement. Although CABs can only engage in limited business activities that explicitly exclude trading activities, FINRA is currently proposing to subject them to three sets of rules. How can that possibly be characterized as a "streamlined" approach?

More than ten years ago, what was then the National Association of Securities Dealers and New York Stock Exchange Regulation promoted the combination of those entities into FINRA. The industry was told repeatedly that one major benefit of combining the regulatory aspect of the securities business into FINRA would allow the use of a single rulebook. Now, we still have many

rule "books" to comply with, including the rules of the SEC, the MSRB, FINRA, securities exchanges, state regulators, the Commodity Futures Trading Commission and the National Futures Association. And let us not forget the Department of Labor that has now issued 1,000 pages of rules to govern how we deal with certain customers. No wonder firms are finding it hard to hire compliance officers.

As we've noted in a prior comment letter to the CAB Proposal, one benefit of this suggestion to create a separate set of CAB Rules is FINRA's tentative recognition that rules should not be designed as one-size-fits-all. The CAB Rules promote special rules for special broker-dealer business activities, tacitly recognizing that certain activities create less risk to investors. We applaud that effort conceptually, but imposing multiple sets of sources for compliance implementation is a cure worse than the disease it is meant to cure.

B. The Definitional Approach

CAB Rule 016(c)(1) defines a "capital acquisition broker" by clearly describing the business activities in which CABs may engage and confirms the limited scope of CAB activities in the exclusions provided in CAB Rule 016(c)(2). In our view, that is all that is needed[19]. The logical place to add the definition of CABs is in the FINRA 5000 series of rules governing securities offering and trading standards and practices. No separate set of rules is needed – or justifiable.

If FINRA is wedded to the notion of "core FINRA Rules," it can includes them in an IM or Supplementary Material to the definition of a CAB, although FINRA would still have to review that list every time a new rule is promulgated or an old rule amended. By simply adding a definition of CAB to the FINRA Rules, the FINRA By-Laws and the "core" FINRA rules become automatically applicable. No interpretive reconciliations needed.

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[19] That statement assumes that the CAB Proposal receives SEC approval.

FINRA has provided only negligible incentives for a firm to adopt the CAB business model. We still believe the entire Proposal should be jettisoned because it retains the heavy regulatory burden applicable to the broker-dealer industry as a whole and arguably provides negligible benefits.[20] Now that the SEC has instituted proceedings to assess whether the CAB Proposal is inconsistent with the Exchange Act and its rules and regulations, in general, and Sections 15A(b)(6)[21] and (9)[22], in particular, the necessary parties are at the table to provide meaningful inducements to register as a CAB.

Compliance with the Financial Responsibility rules remain the same for both CABs and other FINRA-registered BDs. For most small broker-dealers, the net capital rule does not protect their customers. There is no relief from the annual audit requirement, a significant expense to all FINRA member firms regardless of size because auditors must comply with onerous PCAOB and SEC rules. For publicly-held broker-dealers, the SEC/PCAOB environment cannot be eliminated. But the vast majority of small broker-dealers never hold customer cash or securities and are exempt from compliance with the customer protection rule. Indeed, CABs would effectively be exempt from the customer protection rule since they would be explicitly prohibited from holding customer cash or securities[23], thus marginalizing any benefit from having annual audited financial statements.[24] Eliminating these requirements would not only bring the regulation of CABs more in line with the expenses M&A Brokers will have to incur under the Six Lawyers Letter in a non-regulated environment, it would result in major cost savings and create an incentive for firms to register as CABs. If the SEC and FINRA eliminated these requirements, and did not burden CABs with three sets of rules, they will have created a viable "broker-dealer lite" entity for which many in the financial services industry have been lobbying for many years.[25]

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[20] In our view, eliminating the requirement for an annual compliance meeting is not only minimal, it may, in fact, be injurious because that is a time when colleagues can exchange information, views and suggestions on new and/or updated rules and how best to implement compliance responsibilities in their own firms for the business lines in which they engage. What better way to create a culture of compliance?

[21] This Section requires that FINRA rules prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade and protect both investors and the public interest.

[22] This Section states that FINRA rules can't impose unnecessary or inappropriate burdens on competition.

[23] CAB Rule 016(c)(2).

[24] Annual audited financial statements have to be filed with FINRA, the SEC and a tiny handful of states, but this results in only limited customer benefit because such statements are not usually required to be sent to customers or counterparties.

[25] ABA Task Force Report, discussed in ftn. 1, above.

We appreciate this opportunity to comment on SR-FINRA-2015-054. Should you have any further questions, please feel free to call Howard Spindel at 212-897-1688 or Cassondra Joseph at 212-897-1687, or contact us by e-mail at hspindel@integrated.solutions or cjoseph@integrated.solutions, respectively.

Very truly yours,

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