August 06, 2013

David W. Blass
Chief Counsel
Division of Trading and Markets
The Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Dear Mr. Blass:

I am writing to address the issue of when business brokers and finders must register as broker-dealers under section 15 of the Securities Exchange Act of 1934.[1]

Synopsis

Business brokers have a substantial positive economic impact by making the market for closely held small businesses more efficient, by helping entrepreneurs achieve full value for their business when it is sold and by helping aspiring business owners find business opportunities that are appropriate given their skills and financial resources.

Finders play an important role in introducing entrepreneurs to potential investors and raising the capital necessary to launch or grow their businesses. They can reduce the cost of raising capital and increase the likelihood of raising needed capital, particularly for entrepreneurs who have a limited number of pre-existing relationships with accredited investors.

The current regulatory ambiguity surrounding finders and business brokers impedes small firms' ability to raise capital and has an adverse impact on economic growth and job creation.

For the reasons set forth below, the National Small Business Association (NSBA) supports a regulatory exemption for business brokers to the broker-dealer registration requirements consistent with the principles of the *Country Business* no action letter dated November 8, 2006 but extended to include the sale of a controlling interest in the business rather than being limited to the sale of the entire business. In addition, NSBA supports a regulatory exemption for finders who are not "engaged in the business of effecting transactions in securities for the account of others" or of "buying and selling securities" and, as a integral component of that exemption, the provision of a bright-line safe harbor such that small finders are not deemed to be engaged in the business of being a securities broker or a dealer.

[1] 15 USC § 78o.

Introduction

Section 3(a)(4)(A) of the Securities Exchange Act[2] defines a broker generally as "any person engaged in the business of effecting transactions in securities for the account of others." Section 3(a)(5)(A) of the Securities Exchange Act[3] defines a broker generally as "any person engaged in the business of buying and selling securities (not including security-based swaps, other than security-based swaps with or for persons that are not eligible contract participants) for such person's own account through a broker or otherwise." Each definition contains a long list of exceptions generally for the benefit of banks.

Section 15 of the Securities Exchange Act requires brokers or dealers to register with the Securities and Exchange Commission ("SEC" or "the Commission").

Bad Actors

Although it may seem self-evident, given the often over-heated rhetoric in the debate surrounding private securities offerings, we believe we should make it clear that NSBA supports continued application of the anti-fraud provisions of federal and state securities laws to both registered broker-dealers and to business brokers and finders. NSBA also would support language in the contemplated business broker and finder exemptions that barred those subject to a statutory disqualification from using the exemptions.[4]

Transaction-Based Compensation

The SEC appears to believe that structuring compensation so that it is transaction-based will almost always result in the necessity of registration in the absence of some other specific statutory exemption (e.g. those for banks in section 3 of the Securities Exchange Act). With respect, NSBA believes this is both an incorrect reading of the law and bad public policy.

There is absolutely no mention in the statutory definition of a broker or a dealer of the type or nature of compensation involved. The primary focus of the law is whether the person is "engaged in the business" of "effecting transactions in securities" for the account of others. Ergo, the focus on transaction-based compensation is an unwarranted regulatory creation of the SEC.

We believe that the current SEC analysis is a case of throwing out the small business "baby" with the hedge fund "bath water." SEC staff analysis appears to center on concerns about "conflict of interest."[5] But, in the context of small business trying to raise capital or sell their

[2] 15 USC § 78c(a)(4)(A).
[3] 15 USC § 78c(a)(5)(A).
[4] See Securities Exchange Act section 3(a)(39) [15 USC § 78c(a)(39)]. Obviously, the scope of the unavailability could be narrowed or broadened but dovetailing the unavailability of the exemptions to the statutory disqualification language seems reasonable to us.
[5] E.g., "A Few Observations in the Private Fund Space," Remarks of David W. Blass, April 5, 2013, at the American Bar Association, Trading and Markets Subcommittee, Washington, D.C. "The SEC and SEC staff have long viewed receipt of transaction-based compensation is a hallmark of being a broker. This makes sense to me as the broker

business, success-based compensation usually creates a commonality of interest between the finder or business broker and their principal rather than a conflict of interest. With success fee compensation, the finder has the same interest as his or her small business principal (finding capital) and the business-broker has the same interest as his or her small business principal (selling the business for the best price). With other forms of compensation, the finder or business broker simply has an interest in getting paid. This analysis would be substantially the same if we were talking about real estate brokers, commodities brokers or insurance brokers. As long as it is made clear for whom the broker works (i.e. it is not a case of dual agency), these industries do not regard transaction-based compensation as giving rise to a conflict of interest or as otherwise suspect.

Neither a finder nor a business-broker representing a seller has any fiduciary duty to the buyer. They have a duty of fair and honest dealing, as does the issuer, imposed by other provisions in the securities law[6] and, for that matter, the common law and many state statutes. But that constraint creates no conflict of interest.

As a matter of public policy, we believe that success-based compensation is generally preferable to other forms of compensation in the context of small firms. Allowing small business owners to pay a finder's fee or business brokerage fee to someone who actually did what they said they would do and either brought capital to a business or helped sell a business is one thing. Forcing business owners into having to pay finders or business brokers whether or not they were successful is another. If the aim of regulation is to prevent misrepresentation, fraud and false dealing, it is preferable to pay people for actually doing what they said they would do rather than forcing business owners into the quandary of guessing whether the person will deliver. Moreover, capital starved small businesses are not generally in a position to pay high-priced consultants who do not deliver.

The effort to channel these activities into either registered broker-dealers (with their attendant large fees) or consultants who bill on a basis other than actual success benefits large issuers and broker-dealers but harms small business seeking to grow. We would ask that you consider that your analysis may be inappropriate in the context of small firms and small finders.

The Current SEC Position on Who Should Register as a Broker-Dealer is Overbroad

NSBA believes that the current SEC position on who should be required to register as a broker-dealer is overbroad and significantly exceeds the scope of the statutory registration requirement. The SEC *Guide to Broker-Dealer Registration* (attached to this letter as an appendix) illustrates the point.

The *Guide* suggests that those "finding investors," "making referrals," "finding buyers and sellers of businesses," or participating "in important parts of a securities transaction" "may need to register" as brokers. This is significantly beyond the scope of the statutory definition of a

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regulatory structure is built, at least in large part, around managing the conflict of interest arising from a broker acting as a securities salesman, as compared to an investment adviser which traditionally acts as a fiduciary and which should not have that same type of conflict of interest."

[6] Most notably, section 10 of the Securities Exchange Act (15 USC § 78j).

broker, to wit, "any person engaged in the business of effecting transactions in securities for the account of others."

These criteria are so broad that just about anybody involved in the transaction would be required to register as a broker-dealer. The issuer's accountant and attorney, after all, play an "important part" in a securities transaction. Presumably, so too might a finder or business broker. But the "important part" standard is much broader than the statutory standard. Merely "making referrals" or "finding investors" is not what Congress had in mind when it enacted the Securities Exchange Act and it is not in keeping with the plain meaning of the statute. Making introductions and finding investors does not constitute *effecting securities transactions*.

It is also the case that the current SEC position is a relatively recent innovation in the SEC position dating most notably from the withdraw of the 1985 *Dominion Resources* no action letter in 2000.[7] For the previous six and half decades, the SEC position was substantially different that the position it has adopted in this century.

The inconsistency of the current SEC position with both the underlying statute and previous SEC practice combined with the lack of clear regulatory standards has introduced significant regulatory uncertainty into the analysis of whether registration is required and what activities unregistered persons may engage in. Most importantly, it impedes small firms' ability to access needed capital both by restricting the availability of finders and business brokers and by causing potential problems when successful small firms later seek venture capital or public financing and encounter counsel raising questions about their prior use of finders (or, to a lesser extent, business brokers).

A Business Broker Exemption

NSBA supports a regulatory exemption for business brokers to the broker-dealer registration requirements consistent with the principles of the *Country Business* no action letter dated November 8, 2006 but extended to include the sale of a controlling interest in the business rather than being limited to the sale of the entire business.

Specifically we support an exemption for business brokers from the section 15 registration requirement provided that:

(1) the business broker has a limited role in negotiations between the seller and potential purchasers or their representatives
(2) the business broker does not have the power to bind either party in the transaction;
(3) the business being sold is a going concern and not a "shell" organization;
(4) the business being sold satisfies the size standards for a "small business" pursuant to the small business size regulations issued by the U.S. Small Business Administration;
(5) only assets will be advertised or otherwise offered for sale;

[7] See, e.g., the American Bar Association "Report and Recommendations of the Task Force on Private Placement Broker-Dealers," June 20, 2005 for a discussion of previous SEC practice. See also, e.g., "The "Finder's" Exception from Federal Broker--Dealer Registration," John Polanin, Jr., 40 Cath. U.L. Rev. 787 (1991).

(6) if the transaction is effected by means of securities, it will be a conveyance of a controlling interest of the business's equity securities to a single purchaser or group of purchasers;
(7) the business broker does not advise the two parties whether to issue securities, or otherwise whether to effect the transfer of the business by means of securities, or assess the value of any securities sold (other than by valuing the assets of the business as a going concern);
(8) the business broker's compensation will be determined prior to the decision on how to effect the sale of the business, will be a fixed fee, hourly fee, a commission, or a combination thereof, that is based upon the consideration received by the seller, regardless of the means used to effect the transaction and will not vary according to the form of conveyance (i.e., securities rather than assets);
(9) the business broker will not assist purchasers with obtaining financing, other than providing uncompensated introductions to third-party lenders or help with completing the paperwork associated with loan applications.

We believe this approach is preferable to an approach that requires registration of business brokers. First, it is not clear what would be the statutory basis for such a business broker registration requirement. Second, it is not clear what the Commission would do with such registrations or how and on what basis it would regulate business brokers in a manner distinct from broker-dealers. Third, such a registration requirement would create needless compliance costs and complexity and these costs would ultimately be borne by small businesses.

A Finder Exemption

NSBA supports a regulatory exemption for finders who are not "engaged in the business" of "effecting transactions in securities for the account of others" or of "buying and selling securities." As an integral component of that exemption, we believe it is necessary to create a bright-line safe harbor such that small finders are not deemed to be engaged in the business of being a securities broker or a dealer. Such a bright line safe harbor would eliminate much of the regulatory uncertainty associated with the use of finders.

The safe harbor is meant to ensure finders who assist small businesses to find capital from time to time either as an ancillary activity to some other business (e.g. the practice of law, public accounting, insurance brokerage, etc.) or as main street business colleagues or as friends or family members of the business owner are not treated the same for regulatory purposes as a Wall Street broker-dealer.

Specifically, we support an exemption for finders from the section 15 registration requirement provided that the finder is not "engaged in the business of effecting transactions in securities for the account of others" and that the exemption provide a safe harbor such that a finder is deemed not to be engaged in the business of effecting transactions in securities for the account of others" if the finder meets one or more of the following criteria:

(1) the finder does not receive finder's fees exceeding $250,000 in any year;
(2) the finder does not assist an issuer in raising more than $5 million in any year;

(3) the finder does not assist any combination of issuers in raising more than $10 million in any year; or
(4) the finder does not assist any combination of issuers with respect to more than 10 transactions in any year.

We would also support prohibiting finders from engaging in certain activities to be eligible for this exemption on the grounds that such activities would constitute crossing the line to effecting transactions in securities or providing investment advice (thus triggered investment advisory registration requirements). Among those activities that would be proscribed would be:

(1) holding investor funds or securities;
(2) providing investment advice or recommending the purchase of securities; and
(3) participating materially in negotiations between the issuer and investors.

Money Laundering

SEC staff has expressed some concern about finders and money laundering. Federal "Know Your Customer" rules are voluminous and complex.[8] They impose a tremendous compliance burden on financial institutions. Applying these rules to finders or business brokers would effectively render any contemplated exemption a nullity because the administrative burden would be so high.

Finders would by their nature not hold customer funds and we would support an explicit prohibition of finders doing. Accordingly, we do not see what would be gained from requiring "Know Your Customer" compliance from finders. Investor or issuer funds would, in contrast, be held in a financial institution and be subject to the stringent federal "Know Your Customer" rules and anti money laundering (AML) provisions. We might also add that foreign financial institutions that enter the U.S. financial system and U.S. financial institutions that deal with foreign financial institutions are subject to U.S. "Know Your Customer" rules as well as the increasingly robust international "Know Your Customer" and AML regimes promoted by the OECD Financial Action Task Force (FATF).[9]

Sincerely,

David R. Burton
General Counsel

[8] See, e.g., Internal Revenue Service Rev. Proc 2000-12, "Application Procedures for Qualified Intermediary Status Under Section 1441; Internal Revenue Service Notice 2013-43 "Revised Timeline and Other Guidance Regarding the Implementation of FATCA;" section 326 of the Patriot Act amending the Bank Secrecy Act; 31 C.F.R. § 103.121; FINRA Rule 2090 (Regulatory Notice 11-25, May 2011); etc.

[9] See, e.g., "International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation - the FATF Recommendations," February 16, 2012, available at www.fatf-gafi.org/recommendations .

Appendix
Guide to Broker-Dealer Registration[10]
Division of Trading and Markets1
U.S. Securities and Exchange Commission
April 2008

I. INTRODUCTION

The Securities Exchange Act of 1934 ("Exchange Act" or "Act") governs the way in which the nation's securities markets and its brokers and dealers operate. We have prepared this guide to summarize some of the significant provisions of the Act and its rules. You will find information about whether you need to register as a broker-dealer and how you can register, as well as the standards of conduct and the financial responsibility rules that broker-dealers must follow.

CAUTION — MAKE SURE YOU FOLLOW ALL LAWS AND RULES

Although this guide highlights certain provisions of the Act and our rules, it is not comprehensive. Brokers and dealers, and their associated persons, must comply with all applicable requirements, including those of the U.S. Securities and Exchange Commission ("SEC" or "Commission"), as well as the requirements of any self-regulatory organizations to which the brokers and dealers belong, and not just those summarized here.

The SEC staff stands ready to answer your questions and help you comply with our rules. After reading this guide, if you have questions, please feel free to contact the Office of Interpretation and Guidance at (202) 551-5777 (e-mail tradingandmarkets@sec.gov) or the Regional Office of the SEC in your area. You will find a list of useful phone numbers at the end of this guide, or on the SEC's website at www.sec.gov/contact.shtml.

You may wish to consult with a private lawyer who is familiar with the federal securities laws, to assure that you comply with all laws and regulations. The SEC staff cannot act as an individual's or broker-dealer's lawyer. While the staff attempts to provide guidance by telephone to individuals who are making inquiries, the guidance is informal and not binding. Formal guidance may be sought through a written inquiry that is consistent with the SEC's guidelines for no-action, interpretive, and exemptive requests.

II. WHO IS REQUIRED TO REGISTER

Most "brokers" and "dealers" must register with the SEC and join a "self-regulatory organization," or SRO. This section covers the factors that determine whether a person is a broker or dealer. It also describes the types of brokers and dealers that do not have to register with the SEC. Self-regulatory organizations are described in Part III, below.

A note about banks: The Exchange Act also contains special provisions relating to brokerage and dealing activities of banks. Please see Sections 3(a)(4)(B) and 3(a)(5)(C) and related provisions,

[10] Available at http://www.sec.gov/divisions/marketreg/bdguide.htm#II.

and consult with counsel. Aspects of bank dealer activity are discussed in a publication issued by the SEC's Division of Trading and Markets, entitled "Staff Compliance Guide to Banks on Dealer Statutory Exceptions and Rules," which is available on the SEC's website at: http://www.sec.gov/divisions/marketreg/bankdealerguide.htm. Bank brokerage activity is addressed in Regulation R, which was adopted jointly by the Commission and the Board of Governors of the Federal Reserve System. See Exchange Act Release No. 56501 (September 24, 2007) http://www.sec.gov/rules/final/2007/34-56501.pdf.

A. Who is a "Broker"

Section 3(a)(4)(A) of the Act generally defines a "broker" broadly as
any person engaged in the business of effecting transactions in securities for the account of others.

Sometimes you can easily determine if someone is a broker. For instance, a person who executes transactions for others on a securities exchange clearly is a broker. However, other situations are less clear. For example, each of the following individuals and businesses may need to register as a broker, depending on a number of factors:

- "finders," "business brokers," and other individuals or entities that engage in the following activities:
    - Finding investors or customers for, making referrals to, or splitting commissions with registered broker-dealers, investment companies (or mutual funds, including hedge funds) or other securities intermediaries;
    - Finding investment banking clients for registered broker-dealers;
    - Finding investors for "issuers" (entities issuing securities), even in a "consultant" capacity;
    - Engaging in, or finding investors for, venture capital or "angel" financings, including private placements;
    - Finding buyers and sellers of businesses (i.e., activities relating to mergers and acquisitions where securities are involved);
- investment advisers and financial consultants;
- foreign broker-dealers that cannot rely on Rule 15a-6 under the Act (discussed below);
- persons that operate or control electronic or other platforms to trade securities;
- persons that market real-estate investment interests, such as tenancy-in-common interests, that are securities;
- persons that act as "placement agents" for private placements of securities;
- persons that market or effect transactions in insurance products that are securities, such as variable annuities, or other investment products that are securities;
- persons that effect securities transactions for the account of others for a fee, even when those other people are friends or family members;
- persons that provide support services to registered broker-dealers; and
- persons that act as "independent contractors," but are not "associated persons" of a broker-dealer (for information on "associated persons," see below).

In order to determine whether any of these individuals (or any other person or business) is a broker, we look at the activities that the person or business actually performs. You can find analyses of various activities in the decisions of federal courts and our own no-action and interpretive letters. Here are some of the questions that you should ask to determine whether you are acting as a broker:

- Do you participate in important parts of a securities transaction, including solicitation, negotiation, or execution of the transaction?
- Does your compensation for participation in the transaction depend upon, or is it related to, the outcome or size of the transaction or deal? Do you receive trailing commissions, such as 12b-1 fees? Do you receive any other transaction-related compensation?
- Are you otherwise engaged in the business of effecting or facilitating securities transactions?
- Do you handle the securities or funds of others in connection with securities transactions?

A "yes" answer to any of these questions indicates that you may need to register as a broker.

B. Who is a "Dealer"

Unlike a broker, who acts as agent, a dealer acts as principal. Section 3(a)(5)(A) of the Act generally defines a "dealer" as:

> any person engaged in the business of buying and selling securities for his own account, through a broker or otherwise.

The definition of "dealer" does not include a "trader," that is, a person who buys and sells securities for his or her own account, either individually or in a fiduciary capacity, but not as part of a regular business. Individuals who buy and sell securities for themselves generally are considered traders and not dealers.

Sometimes you can easily tell if someone is a dealer. For example, a firm that advertises publicly that it makes a market in securities is obviously a dealer. Other situations can be less clear. For instance, each of the following individuals and businesses may need to register as a dealer, depending on a number of factors:

- a person who holds himself out as being willing to buy and sell a particular security on a continuous basis;
- a person who runs a matched book of repurchase agreements; or
- a person who issues or originates securities that he also buys and sells.
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Here are some of the questions you should ask to determine whether you are acting as a dealer:

- Do you advertise or otherwise let others know that you are in the business of buying and selling securities?
- Do you do business with the public (either retail or institutional)?

- Do you make a market in, or quote prices for both purchases and sales of, one or more securities?
- Do you participate in a "selling group" or otherwise underwrite securities?
- Do you provide services to investors, such as handling money and securities, extending credit, or giving investment advice?
- Do you write derivatives contracts that are securities?

A "yes" answer to any of these questions indicates that you may need to register as a dealer.

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