COUNTRY UPDATE ON THE UNITED STATES

Capital Acquisition Brokers: A New SEC Registration Category Providing Clarity and Relief for M&A Brokers

By Kenneth J. Stuart, Becker, Glynn, Muffly, Chassin & Hosinski LLP (kstuart@beckerglynn.com)

Securities brokers conducting business in the United States, generally referred to as broker-dealers, are required to be registered with the U.S. Securities and Exchange Commission (the "SEC") pursuant to the requirements of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), although limited exceptions might apply to non-U.S. broker-dealers who are in compliance with certain Rules adopted by the SEC. Companies and individuals that limit their activities to mergers and acquisitions and private capital raising advisory services often find SEC broker-dealer registration costly and burdensome. Such companies and individuals instead have acted as "finders" who are not required to be registered with the SEC. Determining whether a person is acting as a finder or a broker-dealer is often challenging, and erring in the determination and failing to register with the SEC can have significant adverse consequences to the finder, including SEC enforcement proceedings.

A "broker" is defined in the Exchange Act as "any person engaged in the business of effecting transactions in securities for the accounts of others." A "dealer" is defined as a person that is "engaged in the business of buying and selling securities…for such person's own account, excluding a person that buys and sells securities for its own account, but not as part of a regular business." On the contrary, the federal securities laws do not define the term "finder." To determine whether a person advising on a M&A transaction, or on a capital raising transaction, is operating solely as a finder, or whether that person has crossed the line and strayed into broker-dealer territory, with the potential adverse consequences noted above, it is necessary to become familiar with guidance provided by the SEC through various no-action letters and in other releases and commentary. What is clear is that a finder cannot receive transaction-based compensation without being at substantial risk of SEC enforcement action.

On January 31, 2014, the staff of the SEC issued a no-action letter (the "M&A Brokers' Letter") stating that it would not recommend enforcement action if a "M&A Broker" were to engage in the activities described in the no-action requesting letter in connection with the purchase or sale of a privately-held company without registering as a broker-dealer under the Exchange Act. The requesting letter described ten activities proposed to be engaged in by the M&A Broker, including that the M&A Broker must not provide, directly or through an affiliate, transaction financing, that no public offering of or sale of securities can be involved in the acquisition, that if a group of buyers is formed for the acquisition, any such group must be formed without the assistance of the M&A Broker, and upon completion of the transaction, the buyer must control and actively operate the target company.

Because of the limitations enumerated in the M&A Brokers' Letter, which in practice have proven to be too restrictive for many market participations, and the uncertainty with respect to the issue of whether broker-dealer registration is required for finders or others advising on raising capital or who facilitate sales and acquisitions of businesses, the Financial Industry Regulatory Authority ("FINRA") proposed, and the SEC approved on August 18, 2016, a FINRA rule creating a new category of broker-dealers known as Capital Acquisition Brokers or "CABs." A CAB is essentially a broker-dealer that limits its business to M&A advisory work and/or corporate financing transactions, and as such the regulatory burdens of full SEC registration are significantly lessened.

CABs may advise on M&A transactions and on capital raising activities, including assisting in the preparation of offering materials for the sale of securities, providing fairness opinions, assisting in negotiating and structuring M&A transactions, and receiving transaction-based compensation for such activities.

It remains to be seen whether the new CAB registration category provides sufficient relief from full SEC and FINRA broker-dealer registrations to encourage firms that limit their activities to investment banking to register as CABs, or whether the constraints on what business may be conducted by a CAB results in relatively few broker-dealers taking advantage of and registering under this new CAB registration category.