



May 18, 2015

Via Email to:

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Re: Proposed NASAA Model M&A Broker Rule – Second Request for Comments

Ladies and Gentlemen:

We appreciate this opportunity to provide these supplemental comments on the model M&A broker rule proposed by the North American Securities Administrators Association (NASAA). We strongly support NASAA's proposed model M&A broker rule because it represents the culmination of years of extensive and thoughtful dialog among all stakeholders. Upon adoption, we ask that NASAA strongly encourage its state members to adopt the model rule in their jurisdictions.

In April 2015, NASAA published a *Notice of Request for Additional Comments Regarding a Proposed NASAA Model Rule Exempting Certain Merger and Acquisition Brokers from Registration pursuant to State Securities Acts*. This comment letter responds to those questions. Please see our initial comment letter dated February 16, 2015 responding to NASAA's initial request for public comment.

#### Our Association and its Members

The Alliance of Merger & Acquisition Advisors (AM&AA or The Alliance) is an international professional association of merger and acquisitions (M&A) intermediaries and related professionals. The Alliance serves the educational and transactional support needs of middle market M&A professionals worldwide. The Alliance was formed in 1998 to connect M&A intermediaries, CPAs, attorneys, and other experienced corporate financial investors and advisors, and currently has more than 900 professionals that are among the most highly recognized leaders in the industry—drawing upon proven capital resources combined with a think-tank of transactional expertise to better serve the many business investment needs of middle market companies worldwide. Some of our members are registered broker-dealers and others are unregistered in reliance upon various registration exemptions, including no-action letters.

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Our members serve corporate and institutional sellers and buyers of privately held businesses with a wide range of transaction values. These essential corporate financial advisory and transaction services include investment banking, business brokerage, accounting, finance, valuation, tax, law, and due diligence. More information about our association is available on our website at: <http://www.amaaonline.com/>.

### **Second Request for Comments**

The Broker-Dealer Section's questions are repeated below, followed by our comments.

1. *A commenter has suggested that the Proposed Rule should be clearer in its prohibition of a Merger and Acquisition Broker facilitating a capital raise for an issuer through a Rule 506(c) offering which is independent from an M&A Transaction. NASAA intends for the Proposed Rule to prohibit a Merger and Acquisition Broker from participating in an issuer capital raise using a Regulation D, Rule 506 offering for something other than an M&A Transaction. In your opinion, does the Proposed Rule need to be further clarified as to this point? If so, what clarification would be useful?*

We believe that the model rule, as proposed, is sufficiently clear that it applies only in the context of an M&A transaction involving an active buyer acquiring control over the target business and not a capital-raising transaction involving passive investors. Key definitions and related text in the proposed model rule plainly state the model rule's conditions and limitations and, in our view, do not describe capital-raising transactions outside the context of an M&A transaction. These key definitions parallel similar language used by the Securities and Exchange Commission (SEC) staff in describing an M&A broker's permissible activities in the *M&A Broker* no-action letter dated January 31, 2014.

More specifically, the model rule's key terms include "transfer of ownership", "control", and "active in the management" in describing the characteristics of the buyer of an eligible privately held company. These characteristics of a business buyer are distinctly different than passive investors in capital-raising transactions. In M&A transactions, these characteristics assure that the buyer will have the ability to directly access all available information about the acquired business, and will also be actively involved with its on-going operation. As defined a "merger and acquisition broker" is limited to activities as follows:

*"(iii) Merger and Acquisition Broker. The term "Merger and Acquisition Broker" means any broker and any person associated with a broker engaged in the business of effecting securities transactions solely in connection with the transfer of ownership of an eligible privately held company, regardless of whether that broker acts on behalf of a seller or buyer, through the purchase, sale, exchange, issuance, repurchase, or redemption of, or a business combination involving, securities or assets of the eligible privately held company, if the broker reasonably believes that—*

“(I) upon consummation of the transaction, any person acquiring securities or assets of the eligible privately held company, acting alone or in concert, will control and, directly or indirectly, will be active in the management of the eligible privately held company or the business conducted with the assets of the eligible privately held company; and

(Emphasis added).

Moreover, the bill’s definition of “control” similarly limits the registration exemption’s application to M&A transactions. Specifically, the rule provides:

The term “control” means the power, directly or indirectly, to direct the management or policies of a company, whether through ownership of securities, by contract, or otherwise. There is a presumption of control for any person who—

(I) is a director, general partner, member or manager of a limited liability company, or officer exercising executive responsibility (or has similar status or functions);

(II) has the right to vote 20 percent or more of a class of voting securities or the power to sell or direct the sale of 20 percent or more of a class of voting securities; or

(III) in the case of a partnership or limited liability company, has the right to receive upon dissolution, or has contributed, 20 percent or more of the capital.

This language makes clear that the prospective buyer is not a passive investor; rather, the buyer must not only have the power to be involved, but also be active, in running the acquired business.

As defined, at least three conditions in the rule distinguish M&A transactions from capital-raising. There must be a transfer of ownership. The buyer must acquire control, including the power to manage or set policies to run the business. The buyer must be active in managing the acquired business. These elements are absent from capital-raising transactions involving passive investors.

We note that the SEC’s Regulation D, Rule 506, including subparagraph (c), provides a “safe harbor” exemption from securities registration in both capital-raising transactions and M&A transactions. Specifically, the SEC’s Form D is used to report to the SEC and the states securities offerings made in reliance upon Rule 506. Form D, Item 10, *Business Combination Transaction*, specifically asks if the securities offering being reported is an M&A/business combination transaction. So, no implication about the type of securities transaction arises simply

by reference to SEC Rule 506. This rule's safe harbor exemption from securities registration is available and applies to both capital-raising and M&A transactions.

We also believe the model rule should closely parallel the proposed statutory language used in pending federal legislation, S. 1010, *the Small Business Mergers, Acquisitions, and Sales Brokerage Simplification Act of 2015*. The language used in this legislation was reviewed by the SEC staff prior to the mark-up of its predecessor bill, H.R. 2274, in November 2013. The SEC staff expressed no concerns or reservations about the scope of the legislation, but asked only that the bill be turned into a self-effecting exemption, as was noted on the record by Congresswoman Maxine Waters, then Ranking Member of the U.S. House Financial Services Committee. The SEC's requested changes were made without objection. The SEC's *M&A Broker* no-action letter using substantially similar operative language was issued two months after the bill's mark-up, and two weeks after H.R. 2274 unanimously passed the U.S. House of Representatives.

2. *A commenter has raised the issue of whether a Merger and Acquisition Broker would be prohibited under the Proposed Rule from advertising an "eligible privately held company" for sale. Should there be clarification in the Proposed Rule about advertising? Should the Proposed Rule specifically regulate what the advertisement should include, such as a description of the business, its general location, and a price range? Should the Proposed Rule speak to the mode of communication for the advertisement (oral, written, electronic)?*

We are not opposed to adding a clarification to the model rule but we believe that it is unnecessary. The SEC staff have long explicitly recognized and allowed without objection the general marketing of a business for sale in its no-action letters dating back to 1986, including, for example, the *International Business Exchange Corporation* no-action letter, the *Country Business, Inc.* no-action letter (2006), and most recently the *M&A Broker* no-action letter. Publicly advertising the availability of a business for sale is inherently different than marketing a company's securities. General advertising of the availability of a generically described business for sale benefits prospective sellers by potentially increasing the universe of prospective buyers. However, prospective sellers rarely want to make it publicly known—by name—that their business is for sale because of the potential adverse impact of the uncertainty of a potential sale upon employees, customers, and suppliers. Hence it would be extraordinary for a prospective company to be identified by name in a public advertisement of a potential sale.

Moreover, prohibitions against general solicitation for the sale of securities are conditions pertinent to private securities offering exemptions, and are not directly relevant to regulating business brokerage activities *per se*. Indeed, the JOBS Act directed the SEC to allow for general solicitation in connection with the offering of securities to accredited investors. The SEC amended Regulation D, Rule 506, to add subparagraph (c). Many business buyers would be an "accredited investor" as defined in SEC Rule 501(a), and so there should be no restriction upon a prospective seller's ability to market its business to the widest possible audience of prospective buyers. We note that very small M&A transactions where a prospective buyer might not be

an “accredited investor” are typically legally structured as cash-for-assets transactions, and hence are generally not within the jurisdiction of federal or state securities laws. Accordingly, we believe that general solicitation need not be addressed in the M&A broker’s exemption from broker-dealer registration.

3. *Some commenters have suggested that NASAA should remove the size cap restriction for an M&A Transaction from the Proposed Rule? Specifically, should paragraphs (E)(ii)(1)(bb) and (F) be deleted from the Proposed Rule? What would be the risks and benefits of doing so? Should the Proposed Rule include optional language to allow states to limit the size of an M&A Transaction based on local industry standards and needs?*

As explained in our initial comment letter, we are not opposed to removing the size cap to the exemption. The SEC’s *M&A Broker* no-action letter contains no size cap, which we believe evidences the staff’s view that it is not an important investor protection. Moreover, we believe it reflects the SEC staff’s judgment about allocating its own and FINRA’s limited regulatory resources to focus on transactions involving passive investors.

That said, we do believe the proposed size cap is a reasonable compromise and is the same as the size cap in the pending M&A broker legislation, S. 1010. We support retaining the present size cap because of the importance of harmonizing federal and state securities regulation of M&A brokers.

4. *Certain commenters have suggested that it may be premature for NASAA to adopt the Proposed Rule at this juncture because there is not federal legislation which has been adopted on this topic. If you believe that it is premature for NASAA to adopt the Proposed Rule at this juncture, what is the basis for your position?*

We do not believe it is premature for NASAA to adopt a model M&A broker rule, whether that rule parallels the pending federal legislation or the SEC’s *M&A Broker* no-action letter. Both legislation and rulemaking are protracted processes, and adoption of the model rule does not change specific state laws. The model rule is not dependent or conditioned upon the passage of the federal legislation. The substance and operative provisions of the legislation and the no-action letter are consistent notwithstanding some nuances between them. We believe the legislation, by its nature, provides a more suitable framework for a model rule than does an SEC staff no-action letter.

We believe that the legislation and the proposed model rule will achieve unparalleled harmonization between federal and state securities regulation of M&A brokers. Both the legislative and the model rulemaking processes are inherently protracted, and proceeding with them on parallel tracks enables a more expeditious outcome, particularly recognizing that this entire effort commenced in 2006.

5. *By contrast, other commenters have suggested that it is not premature for NASAA to adopt a model rule, but that the Proposed Rule should be more in line with the terms and conditions enumerated by the SEC Letter. Commenters pointed to the fact that the SEC Letter allows for a Merger and Acquisition Broker to advertise a company for sale and to represent both buyer and seller in a transaction. However, the SEC Letter limits a Merger and Acquisition Broker's ability to arrange for financing amongst a group of buyers. The Proposed Rule is silent on all of these issues. If NASAA were to adopt a model rule based on the SEC Letter, what are the risks and benefits of doing so?*

First, as noted above, we believe it is unnecessary to include an issuer offering-related provision or condition limiting general advertising for a company's sale in an exemption from broker-dealer registration, particularly when federal law now permits general solicitation for sales to accredited investors.

Second, the legislation explicitly contemplates that an M&A broker may represent a buyer or seller, and there is no statutory language that would prohibit or prevent a dual agency relationship in the same transaction unless prohibited by other laws. Typically, state real estate brokerage laws apply to the sale of a business because commonly businesses either own or lease real estate. State real estate agency licensing commonly addresses whether or not a dual agency relationship is permitted and dictates whether any related conditions such as disclosure apply.

Third, the SEC Letter limits an M&A broker's ability to arrange for financing amongst a group of buyers. Capital-raising activities are not permitted under the M&A broker legislation, the *M&A Broker* no-action letter, or the proposed model rule. We believe this condition in the no-action letter is overly restrictive. Specifically, we believe a bank-affiliated M&A broker should not be precluded from handling an M&A transaction for which its bank affiliate provides commercial financing for the transaction. Commercial bank financing is typically not regulated as a securities transaction.

We are not opposed to NASAA adopting a model rule based on the SEC M&A broker no-action letter. We note, however, that the SEC's *M&A Broker* no-action letter is not legally binding on any person, not even the SEC, and could be changed at any time by further action of the SEC staff. Hence believe that permanent harmonization of federal and state regulation can be better achieved by predicating the proposed model rule on the federal legislation.

6. *Commenters suggest that there [is] a need to ensure that a Merger and Acquisition Broker is bound by federal anti-money laundering law specifically. While NASAA believes the Proposed Rule does bind a Merger and Acquisition Broker to all federal and state anti-money laundering laws when facilitating an M&A Transaction, should NASAA include additional language to the Proposed Rule for clarification purposes?*

The proposed model rule, the SEC *M&A Broker* no-action letter, and the federal legislation all prohibit an M&A broker from having custody of the funds or securities to be ex-

changed by the parties. According, funding for an M&A transaction must be handled by or between banks from bank accounts established and held by the business buyers and sellers, and so are already subject to the anti-money laundering (AML) requirements applicable to banks in accepting deposits. Moreover, the SEC did not identify AML requirements as a condition or a concern in issuing its *M&A Broker* no-action letter's relief, presumably for similar reasons. The SEC and the Financial Crimes Enforcement Network (*FinCEN*) of the U.S. Department of Treasury jointly adopted the AML requirements applicable to broker-dealers as authorized and directed by the Bank Secrecy Act,<sup>1</sup> and so we believe the SEC staff was certainly aware of the implications of granting exemptive relief from broker-dealer registration in its *M&A Broker* no-action letter.

More specifically, FinCEN administers the Currency and Foreign Transactions Reporting Act of 1970, as amended by the USA PATRIOT Act of 2001 and other legislation, commonly referred to as the "Bank Secrecy Act" (*BSA*).<sup>2</sup> The BSA authorizes the Secretary of the U.S. Department of Treasury to require all "financial institutions" to keep records and file reports that "have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings, or in the conduct of intelligence or counterintelligence activities, including analysis, to protect against international terrorism."<sup>3</sup> For this purpose, Section 5312, *Definitions and Application*, of the BSA defines a "financial institution" in relevant part to include:

(a) In this subchapter—

\* \* \*

(2) "financial institution" means—

\* \* \*

(G) a broker or dealer registered with the Securities and Exchange Commission under the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.);

(H) a broker or dealer in securities or commodities;

(I) an investment banker or investment company;

\* \* \*

(Emphasis added). The statutory definition of "financial institution" in the BSA is explicitly broader than broker-dealers registered as such with the SEC. Nonetheless, the SEC and FinCEN chose to explicitly limit the scope of its AML rules to those subject to SEC registration.

The SEC and FinCEN's jointly adopted AML rule, Chapter X, *Financial Crimes Enforcement Network, Department of the Treasury, Part 1010, General Provisions, Subpart A, General Definitions, Section 1010.100, General Definitions*, provides:

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<sup>1</sup> See the Joint Release, *Customer Identification Programs for Broker-dealers*, 68 Fed. Reg. 25113, 31 C.F.R. Part 103, Rel. No. 34-47752 (May 9, 2003).

<sup>2</sup> The BSA is codified at 12 U.S.C. § 1829b, 12 U.S.C. §§ 1951–1959, 18 U.S.C. §§ 1956, 1957, and 1960, and 31 U.S.C. §§ 5311–5314 and 5316–5332 and notes thereto, with implementing regulations at 31 C.F.R. Chapter X. See 31 C.F.R. § 1010.100(e).

<sup>3</sup> See Title 31, Chapter 53, *Monetary Transactions*, Subchapter II, *Records and Reports on Monetary Instruments Transactions*, Section 5311, *Declaration of Purpose*.

When used in this chapter and in forms prescribed under this chapter, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof, terms shall have the meanings ascribed in this subpart. Terms applicable to a particular type of financial institution or specific part or subpart of this chapter are located in that part or subpart. Terms may have different meanings in different parts or subparts.

\* \* \*

(h) *Broker or dealer in securities.* A broker or dealer in securities, registered or required to be registered with the Securities and Exchange Commission under the Securities Exchange Act of 1934, except persons who register pursuant to section 15(b)(11) of the Securities Exchange Act of 1934.

\* \* \*

Even though the BSA includes in the “financial institution” definition all brokers and dealers in securities, in addition to those that are SEC-registered, the SEC and FinCEN chose to apply the AML rules to those broker-dealers subject to SEC registration. The SEC and FinCEN could have simply defined “broker or dealer in securities” with reference to the statutory definitions of these terms in Sections 3(a)(4) and (5) of the Exchange Act, but instead they chose to limit the rules’ definition to those broker-dealers that are registered or required to be registered with the SEC.

Moreover, we note that FinCEN has not required every “financial institution” within its jurisdiction to become subject to the BSA’s AML requirements. FinCEN initially proposed, and then withdrew, its proposed rulemaking that would have applied AML requirements to investment advisers.<sup>4</sup> In withdrawing its proposed notice of rulemaking FinCEN observed:

Investment advisers must conduct financial transactions for their clients through other financial institutions that are subject to BSA requirements, and their clients assets must be carried at these other financial institutions. Thus, as FinCEN continues to consider the extent to which BSA requirements should be imposed on investment advis[e]rs, their activity is not entirely outside the current BSA regulatory regime.

We are not opposed to including a reminder in the model rule that its exemptive relief does not affect federal or other state laws that may be applicable. However, for the reasons cited by FinCEN with respect to investment advisers, we believe there is no need for NASAA’s proposed model M&A broker rule to address the application of federal AML requirements because the SEC and FinCEN have expressly limited the AML requirements to broker-dealers registered or required to be registered with the SEC.

\* \* \*

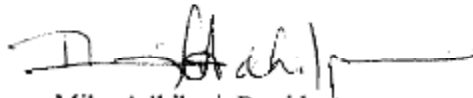
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<sup>4</sup> See FinCEN’s *Withdrawal of the Notice of Proposed Rulemaking: Anti-Money Laundering Programs for Investment Advisers*, 73 Fed. Reg. 65568 (November 4, 2008).



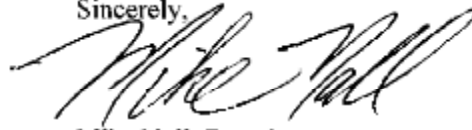
We deeply appreciate the time and effort that NASAA has invested from the beginning of this rulemaking effort over many, many meetings, calls, and presentations. Please do not hesitate to contact us or our securities counsel, Shane Hansen, if you have any questions or need additional information.

Sincerely,



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