

## Capital Acquisition Brokers

### SEC Approves “Pay-to-Play” and Related Rules for Capital Acquisition Brokers (CABs)

Effective Date: December 6, 2017

#### Summary

The Securities and Exchange Commission (SEC) approved<sup>1</sup> Capital Acquisition Broker (CAB) Rule 203 (Engaging in Distribution and Solicitation Activities with Government Entities) and CAB Rule 458 (Books and Records Requirements for Government Distribution and Solicitation Activities). These rules apply established “pay-to-play” and related recordkeeping rules to the activities of member firms that have elected to be governed by the CAB Rules. The rules will allow CABs to engage in distribution or solicitation activities for compensation with government entities on behalf of registered investment advisers.

The rules become effective on December 6, 2017.

The text of the rules is set forth in Attachment A.

Questions concerning this *Notice* should be directed to:

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#### Background and Discussion

##### Pay-to-Play Rules

In July 2010, the SEC adopted Rule 206(4)-5 under the Investment Advisers Act of 1940 addressing pay-to-play practices<sup>2</sup> by investment advisers (SEC Pay-to-Play Rule).<sup>3</sup> The SEC Pay-to-Play Rule prohibits, in part, an investment adviser and its covered associates from providing or agreeing to provide, directly or indirectly, payment to any person to solicit a government entity for investment advisory services on behalf of the investment adviser unless the person is a “regulated person.”<sup>4</sup> A “regulated person” includes a member firm,

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#### Notice Type

- ▶ New Rule

#### Suggested Routing

- ▶ Compliance
- ▶ Government Securities
- ▶ Legal
- ▶ Municipal
- ▶ Registered Representatives
- ▶ Senior Management

#### Key Topics

- ▶ Capital Acquisition Brokers
- ▶ Political Contributions
- ▶ Recordkeeping

#### Referenced Rules & Notices

- ▶ Advisers Act Rule 206(4)-5
- ▶ CAB Rule 203
- ▶ CAB Rule 458
- ▶ FINRA Rule 2030
- ▶ FINRA Rule 4580

provided that: (a) FINRA rules prohibit member firms from engaging in distribution or solicitation activities if political contributions have been made; and (b) the SEC finds, by order, that such rules impose substantially equivalent or more stringent restrictions on member firms than the SEC Pay-to-Play Rule imposes on investment advisers and that such rules are consistent with the objectives of the SEC Pay-to-Play Rule.<sup>5</sup>

Based on this regulatory framework, on August 25, 2016, the SEC approved FINRA Rules 2030 and 4580 to establish a comprehensive regime to regulate the activities of member firms that engage in distribution or solicitation activities with government entities on behalf of investment advisers.<sup>6</sup> On September 20, 2016, the SEC, by order, found that FINRA Rule 2030 imposes substantially equivalent or more stringent restrictions on member firms than the SEC Pay-to-Play Rule imposes on investment advisers and is consistent with the objectives of the SEC Pay-to-Play Rule.<sup>7</sup> These rules enable member firms to continue to engage in distribution and solicitation activities with government entities on behalf of investment advisers while at the same time deterring member firms from engaging in pay-to-play practices. Rules 2030 and 4580 do not expressly apply to CABs.

In October 2016, FINRA published a *Regulatory Notice*<sup>8</sup> announcing SEC approval of FINRA Rules 2030 and 4580, which became effective on August 20, 2017.

### **FINRA Capital Acquisition Broker Rules**

FINRA adopted a separate set of FINRA rules for firms that meet the definition of a “capital acquisition broker” and that elect to be governed under this rule set. CABs are member firms that engage in a limited range of activities, essentially advising companies and private equity funds on capital raising and corporate restructuring, and acting as placement agents for sales of unregistered securities to institutional investors under limited conditions. Member firms that elect to be governed under the CAB rule set are not permitted, among other things, to carry or maintain customer accounts, handle customers’ funds or securities, accept customers’ trading orders, or engage in proprietary trading or market-making.

The CAB Rules became effective on April 14, 2017, after SEC approval.<sup>9</sup> In order to provide new CAB applicants with lead time to apply for FINRA membership and obtain the necessary qualifications and registrations, CAB Rules 101-125 became effective on January 3, 2017.<sup>10</sup>

### **Addition of FINRA Pay-to-Play Rules to CAB Rule Set**

The CAB Rules subject CABs to a number of FINRA Rules, but do not expressly provide that FINRA Rules 2030 and 4580 apply to CABs. As stated above, the SEC Pay-to-Play Rule prohibits, in part, an investment adviser and its covered associates from providing or agreeing to provide, directly or indirectly, payment to any person to solicit a government entity for investment advisory services on behalf of the investment adviser unless the person is a “regulated person.” The SEC Pay-to-Play Rule defines a “regulated person” to include a member firm subject to a FINRA pay-to-play rule.

CAB Rules 203 and 458 make clear that CABs are subject to FINRA’s pay-to-play and related recordkeeping rules and, therefore, that CABs, similarly to non-CAB member firms, are “regulated persons” that can engage in distribution and solicitation activities with government entities on behalf of investment advisers in accordance with the SEC’s Pay-to-Play Rule, while at the same time deterring CABs from engaging in pay-to-play practices.<sup>11</sup>

The rules become effective on December 6, 2017.

## Endnotes

1. See Securities Exchange Act Release No. 81781 (September 29, 2017), 82 FR 46559 (October 5, 2017) (Order Approving File No. SR-FINRA-2017-027).
2. “Pay-to-play” practices typically involve a person making cash or in-kind political contributions (or soliciting or coordinating others to make such contributions) to help finance the election campaigns of state or local officials or bond ballot initiatives as a quid pro quo for the receipt of government contracts. See [Regulatory Notice 16-40](#) (October 2016) at 9, note 1.
3. See Investment Advisers Act Release No. 3043 (July 1, 2010), 75 FR 41018 (July 14, 2010) (S7-18-09) (Political Contributions by Certain Investment Advisers). See also Investment Advisers Act Release No. 3221 (June 22, 2011), 76 FR 42950 (July 19, 2011) (S7-36-10) (Rules Implementing Amendments to the Investment Advisers Act of 1940); Investment Advisers Act Release No. 3418 (June 8, 2012), 77 FR 35263 (June 13, 2012) (S7-18-09) (Political Contributions by Certain Investment Advisers; Ban on Third Party Solicitation; Extension of Compliance Date).
4. See Investment Advisers Act Rule 206(4)-5(a)(2)(i)(A), 17 CFR 275.206(4)-5(a)(2)(i)(A).
5. See Investment Advisers Act Rule 206(4)-5(f)(9), 17 CFR 275.206(4)-5(f)(9). A “regulated person” also includes SEC-registered investment advisers and SEC-registered municipal advisors, subject to specified conditions.
6. See Securities Exchange Act Release No. 78683 (August 25, 2016), 81 FR 60051 (August 31, 2016) (Order Approving File No. SR-FINRA-2015-056). See also Securities Exchange Act Release No. 76767 (December 24, 2015), 80 FR 81650 (December 30, 2015) (Notice of Filing of File No. SR-FINRA-2015-056).
7. See Investment Advisers Act Release No. 4532 (September 20, 2016), 81 FR 66526 (September 28, 2016) (S7-16-16).
8. See [Regulatory Notice 16-40](#) (October 2016).
9. See Securities Exchange Act Release No. 78617 (August 18, 2016), 81 FR 57948 (August 24, 2016) (Order Approving File No. SR-FINRA-2015-054).
10. See [Regulatory Notice 16-37](#) (October 2016).
11. CABs’ distribution and solicitation activities with government entities on behalf of investment advisers must be consistent with the activities permitted for CABs under CAB Rule 016(c).