June 30, 2020

Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Via email to: pubcom@finra.org

RE: Regulatory Notice 20-04
Capital Acquisition Brokers

Thank you for allowing us the opportunity to comment on the proposed Amendments to the Capital Acquisition Broker Rules.

Integrated Solutions ("IS") is one of the largest providers of compliance consulting and financial accounting services to the financial services industry, including about 100 FINRA members, among others types of financial services firms.[1] 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 Materiality Consultations submitted to FINRA on behalf of clients. IS has regular, daily experience with FINRA and its 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.

Most importantly, it seems to us that FINRA should have focused on the previous comment letters presented to FINRA and the SEC with respect to the CAB Rules. While we commented on the rules, Morgan Lewis, a prominent law firm published a white paper, which essentially laid out why the rules were not a great idea for most market participants.

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

See the white paper here:
https://www.morganlewis.com/~/media/files/publication/morgan%20lewis%20title/white%20paper/broker-lite-finra-built-it-but-will-they-come-september2016.ashx?la=en

It is somewhat true that in FINRA's most recent attempt to ameliorate or eliminate the poor features of the CAB Rules, FINRA has failed to recognize that it may very well be better to totally redo the entire process instead of patching up the poorly conceived rules. Actually, the poorly conceived rules include not only the CAB Rules but also other rules as described below.

We note that the explanatory material of Regulatory Notice 20-24 declares some interesting statistics. In the four or so years that the CAB Rules have existed, only 55 FINRA members have elected CAB status. That tells us that the rules were very uninviting. We realize that some firms did not elect CAB status because of some of the rules that seemed overly restrictive yet we don't believe that the proposed amendments go far enough to inspire firms to either register as CABs instead of being regular members or to register as CABs instead of operating without registration either illegally or in conformity with the conditions of the six-lawyers letter issued by the SEC.

Yet these are not necessarily the most telling statistic. The regulatory notice states that "FINRA estimates that there are approximately 700 FINRA-registered CAB-like firms". When we compare the 700 firms to the 55 firms, that suggests to us that the rules that currently govern the 700 firms are way too strict. Not only that, the entire regulatory scheme that applies to those firms imposes unimaginable hardships that have little to do with risk.

For example, a regular CAB-like firm arguably needs to have its AML procedures reviewed every year. If such a firm was a CAB, the procedures would need a review every two years. That tells us that rather than adopt CAB Rule amendments, there should be amendments to the rules applicable currently to CAB-like firms where the risks are essentially minimal. Similarly, CABs would not need branch inspections that are currently applicable under Rule 3110. We know that most CAB-like firm branches are almost always devoid of regulatory implications especially when there is a separate Office of Supervisory Jurisdiction that manages the firm's affairs.

These are just a few examples of why the 700 firms are unhappy with FINRA regulations. Assuming that the vast majority of the 700 firms have fewer than 151 registered persons, we can guess that based upon the 3165 members counted as small firms as mentioned in the recent notice announcing the upcoming Board of Governors election, that 22% of the small firm members are overregulated. Clearly the rules should change for them rather than provide them with the CAB Rules which do not necessarily provide them with necessary flexibility.

We observe that FINRA does not have any special qualifying examinations for CABs. Currently, to sell Direct Placement Programs, a Series 22 is required. To sell corporate private placements, a Series 82 is required. A Series 7 would cover both categories but would it not be nice to have a simple qualification examination that would be good for CABs as well as the 700 CAB-like firms?

With regard to a portion of FINRA's first question, specifically "Are there other categories of activities that FINRA should consider incorporating into the CAB definition without reducing investor protection?" - let us focus for a moment on the area of investor protection.

We at Integrated Solutions would submit that most if not all institutional investors are less concerned with, and in fact do not need, investor protection provided by the entire panoply of SEC and FINRA rules. Rather, they are concerned mainly with fair dealings and protection against fraud. Too many of the current rules are too complex and represent impediments to the capital formation process.

More to the point, FINRA states in its request for comments that FINRA proposes rule amendments to CAB rules to make them more useful to CABs without reducing investor protection. Furthermore, in Attachment A, Section 016. Definitions, paragraph (c)(1)(F), (G) and (H), FINRA defines a Capital Acquisition Broker and outlines certain activities that such Capital Acquisition Broker may engage in. However, relatedly, our clients have 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").[2] Indeed many of them can and yet FINRA's definitions and descriptions of business activities in the above reference paragraphs would imply

[2] 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 FINRA's CAB Rules in general, are FINRA's response to the Six Lawyers Letter so as to keep more business activities within the FINRA regulatory umbrella.

that no such mechanism exists. In fact, we are well aware that there probably are many more entities that are currently engaged in the activities in which CABs operate than there are CABS. There are reasons for that phenomenon.

We should mention that we and others have previously commented on FINRA's CAB Proposals and believe this experience enables us to assess the impact of the current CAB Proposal on current and future FINRA members from both a regulatory and business perspective.

In FINRA's current Request for Comment, Question 3 asks: Do the proposed amendments represent a reasonable incentive for eligible firms to elect CAB status?

We believe that the answer must be: no, the proposed amendments do not go far enough and instead therefore it is not likely that eligible firms will wish to elect CAB status.

As your own Request for Comment document states, "the benefit of electing CAB status is that CABs are subject to few restrictions on specified activities (such as advertising) and have less burdensome supervisory requirements". Furthermore, CAB clients are institutional investors, which "for purposes of CAB rules includes banks, investment companies, large employee benefit plans and "qualified purchasers" under the Investment Company Act of 1940". FINRA now seeks to broaden the definition of institutional investor to include "knowledgeable employees" such as senior officers and directors of private funds and their advisors, amongst others. It seems to us that this crosses the threshold, even if subliminally, into the retail investor sphere. Yes, Regulation BI will apply to these individuals but perhaps this is an unintended consequence brought about by the SEC.

With regard to FINRA's 4th question, "Do the proposed amendments reasonably maintain strong investor protections?" – we at Integrated Solutions believe that many of the amendments to the CAB rules and the current CAB rules themselves are unnecessary and speak directly to FINRA's own discussion of Economic Impact Assessment in this comment request.

This brings us to FINRA's 5th question related to economic impact. Most of Integrated Solutions' client firms have fewer than ten people associated with them. This underscores FINRA's own discussion in the Economic Impact Assessment portion of this comment request, whereby FINRA

refers to “55 member firms that have elected CAB status” “of which 91% have fewer than twenty registered representatives” or “548 registered representatives working across the 55 existing CAB firms”[3] .

These small-sized firms do not have the objective to be in the business of complying with rules. Rather, they must comply with rules to stay in business. To make staying in business, for these firms, an onerous endeavor in terms of economic impact (additional staffing, cost of opportunity etc.), is indefensible.

Ironically, “FINRA estimates that there are approximately 700 FINRA-registered CAB-like firms”. Since these firms are already registered, there is hardly any advantage to them to become a CAB. The fact that the CAB amendments would allow them to do certain additional activities might inspire a handful of firms to become CABs but most firms that already are fully registered would likely find the new benefits available to CABs to not be an incentive at all.

In closing

We thank FINRA for taking the time to read this letter and for offering us the opportunity to offer comment. Please feel free to contact us via email at hspindel@integrated.solutions or rconnell@integrated.solutions or by calling Howard Spindel at 212-897-1688 or Rosemarie Connell at 212-897-1691.

Very truly yours,

Howard Spindel
Senior Managing Director

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[3] Obviously, that means that the average CAB has fewer than 10 people.