



K&L GATES

2016 INVESTMENT MANAGEMENT CONFERENCE

Broker-Dealer Regulatory Update

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FINRA Rulemaking Update

CAPITAL ACQUISITION BROKER RULES

- Established a new series of FINRA Rules (Rules 010 through 1000) applicable to “Capital Acquisition Brokers.”
- A “Capital Acquisition Broker” is defined as a firm that engages solely in a limited range of activities, including:
 - Advising on securities offerings or other such activities (including selection of investment bankers);
 - Acting as a placement agent in private offerings; or
 - Advising companies on purchase and sale of a business or assets.
- Firms meeting the definition of Capital Acquisition Broker and that elect to be subject to the CAB Rules will be subject to a reduced set of FINRA rules
- The CAB Rules are effective April 14, 2017
- [FINRA Regulatory Notice 16-37 \(October 2016\)](#)



PAY-TO-PLAY RULES

- Established new rules modeled after the SEC Pay-to-Play Rule
 - Rule 2030 - Engaging in Distribution and Solicitation Activities with Government Entities
 - FINRA Rule 4580 – Books and Records Requirements for Government Distribution and Solicitation Activities
- The new rules generally prohibit a FINRA member from:
 - Engaging Prohibit a FINRA member firm from distribution or solicitation activities for compensation with a government entity on behalf of an investment adviser that provides or is seeking to provide investment advisory services to such government entity within two years; and
 - Soliciting or coordinating any person to make any such payment to a government official, government entity or political party.
- The pay-to-play rules are effective August 20, 2017
- [FINRA Regulatory Notice 16-40 \(October 2016\)](#)



GIFTS, GRATUITIES AND NON-CASH COMP

- Proposed amendments to Rule 3220 (Influencing or Rewarding Employees of Others), and new Rules 3221 (Restrictions on Non-Cash Compensation) and 3222 (Business Entertainment)
- The proposed amendments, among other things, would:
 - Increase gift limit from \$100 to \$175 per person per year and include de minimis threshold for records of gifts;
 - Amend non-cash compensation rules to apply to all securities, subject to exceptions for gifts from offerors, training or education subject to exceptions and internal sales contests; and
 - Require firms to develop written policies and procedures for business entertainment tailored to its business needs.
- Comment period expired on September 23, 2016.
- [FINRA Regulatory Notice 16-29 \(August 2016\)](#)



AMENDMENTS TO COMMUNICATIONS RULES

- Proposed amendments to FINRA Rules related to Communications with the Public resulting from the retrospective rule review
- The proposed amendments would:
 - Revise the filing requirements in Rules 2210 and 2214, clarifying that the following need not be filed:
 - Retail communications including generic investment company materials;
 - Annual and semiannual shareholder reports that have been filed with the SEC;
 - Offering documents related to securities offerings that are exempt from registration; and
 - Ranking and comparison backup material (instead such material must be maintained by the firm)
 - Revise the content and disclosure requirements of Rule 2213 to: no longer require that communications including a bond volatility rating be accompanied or preceded by a prospectus, to allow them to be filed within 10 days after first use and to streamline the content and disclosure requirements.
- The amendments are effective on January 9, 2017
- [FINRA Regulatory Notice 16-41 \(October 2016\)](#)



CERTAIN OTHER FINRA RULEMAKING

- [Amendments to FINRA Rule 2210 to conform to FINRA Rule 2242 \(Debt Research Analysts and Debt Research Reports\)](#)
 - Effective on July 13, 2016.

- [Coordination with the MSRB \(Rule 0151\)](#)
 - Effective on February 29, 2016.

- [Enhanced Price Disclosures to Retail Investors in Fixed-Income Securities](#)
 - Comment period expired on September 23, 2016.

- [Mandatory BC/DR Testing Under Regulation SCI \(Rule 4380\)](#)
 - Effective on November 3, 2015.



RECENT FINRA GUIDANCE

- [Best Execution by Brokers and Dealers](#)
 - MSRB and FINRA coordinated guidance establishing the first best-execution rule for transactions in municipal securities.
 - Issued on November 20, 2015.
- [Forum Selection Provisions](#)
 - Customers have a right under FINRA Rule 12200 to request arbitration at FINRA's arbitration forum at any time and do not forfeit that right by signing an agreement stating otherwise.
 - Issued on July 22, 2016.
- [Firm Obligations When Providing Stock Quote Information to Customers](#)
 - Rule 603(c) of regulation NMS obligations.
 - Issued in December 2015.
- [Private Placements and Public Offerings Subject to a Contingency](#)
 - FINRA finds instances in which broker-dealers have not complied with the contingency offering requirements of Rules 10b-9 and 15b2-4 under the SEA
 - Issued in February 2016.



RECENT FINRA SWEEP EXAMS

- Mutual Fund Fee Waiver Sweep
 - Commenced in May 2016
 - Focus on controls to ensure mutual fund sales charge waivers are provided to eligible accounts, including retirement plans and charitable accounts

- Targeted Sweep of Firms' "Cultural Values"
 - Focused on assessment of "firm culture"
 - Firms were required to respond by March 31, 2016.

- Review of Unit Investment Trust Rollover
 - Focused on assessment of early rollovers
 - Firms were required to respond by March 31, 2016.





Crowdfunding



REGULATION CROWDFUNDING

- Crowdfunding Overview:
 - Title III of the JOBS Act created new exemption from registration under the 1933 Act for offerings of less than \$1 million (Section 4(a)(6) of the 1933 Act)
 - No restrictions on type of securities that may be offered and sold
 - Limitations on aggregate amount of securities that can be sold to any single investor in any 12-month period (based on annual income or net worth)
 - Issuers must file Form C with the SEC
- Regulation CF offerings must be conducted through a broker or a “funding portal”
- “Funding portals” are intermediaries in Reg. CF transactions that do not:
 - Offer investment advice or recommendations
 - Solicit purchases, sales or offers to buy securities displayed on website/portal
 - Compensate employees or agents for solicitation based on sales of securities
 - Hold, manage or handle customer funds or securities
- Funding portals meeting these requirements are exempt from registration as “brokers,” but must become members of a national securities association (i.e., FINRA)



FINRA FUNDING PORTAL RULES

- FINRA adopted new Funding Portal rules and related forms, effective January 29, 2016
- Rules written specifically for funding portals given their limited scope of activities
 - Streamlined membership application rules
 - Anti-fraud; high standards of commercial honor and just and equitable principles of trade
 - Supervisory system reasonably designed to achieve compliance with securities laws
 - FINRA jurisdiction for investigations and sanctions
 - Dispute resolution procedures
- In addition, new w FINRA Rule 4518 (Notification to FINRA in Connection with the JOBS Act) requires registered broker-dealer members of FINRA to notify FINRA prior to engaging in Crowdfunding transactions



CROWDFUNDING – MARKET UPDATE

- Effective May 16, 2016, the general public may invest in start-ups through Crowdfunding transactions
- 19 funding portals currently registered with FINRA
- 155 Form C filings
- Flavors of “crowdfunding”

Fundraising (i.e., not crowdfunding)	Equity crowdfunding	Angel/venture platforms	Lending platforms
<ul style="list-style-type: none"> • Kickstarter • Indiegogo • Gofundme • YouCaring • Crowdrise 	<ul style="list-style-type: none"> • SeedInvest • Wefunder • CrowdBoarders 	<ul style="list-style-type: none"> • AngelList • CircleUp • FundersClub • Crowdfunder • AgFunder • MicroVentures 	<ul style="list-style-type: none"> • Prosper • Funding Circle • Kiva • LendInvest • Lending Club





Enforcement Matters



BLACKSTREET CAPITAL MANAGEMENT

- SEC enforcement against private equity fund adviser and its principal owner
- Failure to follow terms of fund governing documents
- Engaging in brokerage activity without registering as a broker-dealer
 - The firm received transaction-based compensation in exchange for soliciting deals, identifying buyers and sellers, negotiating and structuring transactions, arranging financing, and executing transactions.
 - Note: Fund governing documents permitted these activities/fees.
- \$2.4 million disgorgement, \$784,000 penalty & interest



DEUTSCHE BANK SECURITIES INC.

- Dissemination of confidential and material non-public information over “squawk boxes”
- Firm ignored red flags indicating that its supervision was inadequate, including warnings from internal audit, compliance and risk
- FINRA enforcement focus was on recognizing and responding to red flags
- \$12.5 million fine



OPPENHEIMER & CO.

- Sales of leveraged, inverse and inverse-leveraged exchange-traded funds (non-traditional ETFs) to retail customers without reasonable supervision
- Firm had policies restricting sales of non-traditional ETFs, but failed to reasonably enforce them
- FINRA also alleged a lack of effective surveillance of holding periods for non-traditional ETFs
- \$716,000 restitution, \$2.25 million fine



RAYMOND JAMES

- Failure to establish and implement adequate AML procedures
- “Red flags” of potentially suspicious activity went undetected or inadequately investigated
- Failure to remediate program after previous sanction for AML deficiencies
- \$17 million fine
- AMLCO fined \$25,000 and suspended for 3 months



METLIFE SECURITIES

- Negligent material misrepresentations and omissions on variable annuity (VA) replacement applications for tens of thousands of customers
 - Principals ultimately approved 99.79% of VA replacement applications
 - Deficiencies found in 72% of them
- Inadequate supervision, inadequate training
- \$5 million restitution, \$20 million fine



BARCLAYS CAPITAL

- Unsuitable mutual fund sales
- Failure to supervise unsuitable mutual fund switches
- Failure to supervise
 - During a six-month look back review, 39% of mutual fund transactions were found to be unsuitable
- Failure to aggregate purchases and apply breakpoint discounts
- \$10 million restitution, \$3.75 million fine

