

September 29, 2017

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving a Proposed Rule Change Relating to Capital Acquisition Broker Rules 203 (Engaging in Distribution and Solicitation Activities with Government Entities) and 458 (Books and Records Requirements for Government Distribution and Solicitation Activities)

**I. Introduction**

On August 17, 2017, Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to adopt Capital Acquisition Broker Rules 203 (Engaging in Distribution and Solicitation Activities with Government Entities) and 458 (Books and Records Requirements for Government Distribution and Solicitation Activities). These rules would apply established “pay-to-play” and related recordkeeping rules to the activities of member firms that have elected to be governed by the Capital Acquisition Broker (“CAB”)<sup>3</sup> Rules and that engage in distribution or solicitation activities for compensation with government entities on behalf of investment advisers.

The proposed rule change was published for comment in the Federal Register on

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> 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. See FINRA Regulatory Notice 16-37 (October 2016), at 1.

August 24, 2017.<sup>4</sup> The public comment period closed on September 14, 2017. No comment letters were received in response to the Notice. This order approves the proposed rule change.

## **II. Description of the Proposed Rule Change**

As discussed in the Notice and described below, the proposed rule change seeks to clarify that FINRA’s existing pay-to-play rules and related recordkeeping requirements apply to CABs. Under the proposed rules, CABs would be subject to the same restrictions designed to halt pay-to-play practices as non-CAB member firms, which would effectively allow them to engage in distribution and solicitation activities with government entities on behalf of investment advisers.<sup>5</sup>

### **A. 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 by investment advisers (the “SEC Pay-to-Play Rule”).<sup>6</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

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<sup>4</sup> See Exchange Act Release No. 81438 (August 17, 2017), 82 FR 40181 (August 24, 2017) (Notice of Filing of a Proposed Rule Change Relating to Capital Acquisition Broker Rules 203 and 458) (“Notice”).

<sup>5</sup> “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 as a quid pro quo for the award of government contracts. See FINRA Regulatory Notice 16-40 (October 2016) at 9, note 1.

<sup>6</sup> See Investment Advisers Act Release No. 3043 (July 1, 2010), 75 FR 41018 (July 14, 2010) (Political Contributions by Certain Investment Advisers). See also Investment Advisers Act Release No. 3221 (June 22, 2011), 76 FR 42950 (July 19, 2011) (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) (Political Contributions by Certain Investment Advisers; Ban on Third Party Solicitation; Extension of Compliance Date).

the person is a “regulated person.”<sup>7</sup> A “regulated person” includes a member firm, 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>8</sup>

Based on the framework of the SEC Pay-to-Play Rule, FINRA proposed Rules 2030 and 4580, which establish a comprehensive regime to regulate the activities of FINRA member firms that engage in distribution or solicitation activities with government entities on behalf of investment advisers, and to deter member firms from engaging in pay-to-play practices.<sup>9</sup> The SEC approved these rules on August 25, 2016,<sup>10</sup> and later found that Rule 2030 imposes substantially equivalent or more stringent restrictions on member firms than the SEC Pay-to-Play Rule imposes on investment advisers, and that it is consistent with the objectives of the SEC Pay-to-Play Rule.<sup>11</sup> Rules 2030 and 4580 became effective on August 20, 2017.<sup>12</sup>

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<sup>7</sup> See Investment Advisers Act Rule 206(4)-5(a)(2)(i)(A), 17 CFR 275.206(4)-5(a)(2)(i)(A).

<sup>8</sup> 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 advisers, subject to specified conditions.

<sup>9</sup> See Securities Exchange Act Release No. 76767 (December 24, 2015), 80 FR 81650 (December 30, 2015).

<sup>10</sup> See Securities Exchange Act Release No. 78683 (August 25, 2016), 81 FR 60051 (August 31, 2016).

<sup>11</sup> See Investment Advisers Act Release No. 4532 (September 20, 2016), 81 FR 66526 (September 28, 2016).

<sup>12</sup> See FINRA Regulatory Notice 16-40 (October 2016).

B. FINRA CAB Rules

On August 18, 2016, the SEC approved a separate set of FINRA rules for firms that meet the definition of a CAB and that elect to be governed under this rule set.<sup>13</sup> 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. 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.

C. Addition of FINRA Pay-to-Play Rules to CAB Rulebook

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 explained by FINRA in the Notice, the proposed rule change sought to make clear that CABs are subject to FINRA's pay-to-play rule, which would make CABs, like non-CABs, "regulated persons" that are subject to restrictions designed to halt pay-to-play practices and thus 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.

To make this clarification, FINRA proposed the addition of CAB Rules 203 and 458 to the CAB rule book. CAB Rule 203 would provide that all capital acquisition brokers are subject to existing FINRA Rule 2030. CAB Rule 458 would provide that all capital acquisition brokers are subject to existing FINRA Rule 4580.

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<sup>13</sup> See Securities Exchange Act Release No. 78617 (August 18, 2016), 81 FR 57948 (August 24, 2016) (Order Approving Rule Change as Modified by Amendment Nos. 1 and 2 to Adopt FINRA Capital Acquisition Broker Rules).

### **III. Comment Summary**

As noted above, no comment letters were received on the proposed rule change.

### **IV. Discussion and Commission Findings**

After careful review of the proposed rule change, the Commission finds that the proposal is consistent with the requirements of the Exchange Act and the rules and regulations thereunder that are applicable to a national securities association.<sup>14</sup> The Commission finds that the proposed rule change is consistent with Section 15A(b)(6) of the Exchange Act,<sup>15</sup> which requires, among other things, that FINRA rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. Specifically, the Commission finds that the proposed rule change is consistent with the Exchange Act for the reasons expressed in the Order Approving a Proposed Rule Change to Adopt FINRA Rule 2030 – namely, that this proposed rule will discourage CABs, like non-CAB member firms, from engaging in pay-to-play practices that may create market distortions, impede a free and open market, and harm investors and the public interest.<sup>16</sup>

The Commission agrees with FINRA that the proposed rule change will clarify that CABs and non-CAB member firms are subject to the same rule regime as they engage in distribution or solicitation activities with government entities on behalf of investment advisers. Without the proposed rule change, under the SEC's Pay-to-Play Rule, CABs could not be retained by investment advisers to engage in distribution and solicitation activities with

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<sup>14</sup> In approving this rule change, the Commission has considered the rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>15</sup> 15 U.S.C. 78o-3(b)(6).

<sup>16</sup> See Securities Exchange Act Release No. 78683 (August 25, 2016), 81 FR at 60063 (August 31, 2016).

government entities on their behalf because the rule set for CABs does not expressly provide that FINRA Rule 2030 applies to CABs. The Commission also agrees with FINRA that having such rules in place will deter CABs from engaging in pay-to-play practices, and that clarifying the application of FINRA Rules 2030 and 4580 to CABs is a more effective regulatory response to concerns regarding third-party solicitations than an outright ban on such activity.

Lastly, the Commission agrees with FINRA that the proposed rule change will not result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act. In the Notice, FINRA explained that the proposed rule change would subject CABs to the same pay-to-play rules as non-CAB member firms, and therefore, the economic impacts associated with the proposal were contemplated in the Economic Impact Assessment accompanying the filing of FINRA Rules 2030 and 4580. FINRA's Economic Impact Assessment in the Proposing Release for FINRA Rules 2030 and 4580 considered the impact on all FINRA member firms, including firms that at that time engaged solely in activities that were later deemed permissible for CABs.<sup>17</sup>

Taking into consideration the foregoing, the Commission believes that the proposal is consistent with the Exchange Act. The Commission believes that the proposal will help protect investors and the public interest by, among other things, clarifying that CABs and non-CAB member firms are subject to the same rule regime as they engage in distribution or solicitation activities with government entities on behalf of investment advisers, and by deterring pay-to-play practices. Accordingly, the Commission believes that the approach proposed by FINRA is appropriate and designed to protect investors and the public interest,

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<sup>17</sup> See Securities Exchange Act Release No. 76767 (December 24, 2015), 80 FR 81650, 81656-81658 (December 30, 2015) (at the time of the Economic Impact Assessment, the SEC had not approved the separate set of rules for CABs).

consistent with Section 15A(b)(6) of the Exchange Act and the rules and regulations thereunder.

**V. Conclusion**

IT IS THEREFORE ORDERED pursuant to Section 19(b)(2) of the Exchange Act<sup>18</sup> that the proposal (SR-FINRA-2017-027), be and hereby is approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>19</sup>

Eduardo A. Aleman  
Assistant Secretary

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<sup>18</sup> 15 U.S.C. 78s(b)(2).

<sup>19</sup> 17 CFR 200.30-3(a)(12).