

# AM&AA Webinar

## What you need to know about . . .

- How the M&A Broker Proposal could bring you into compliance with federal and state securities laws;
- Why FINRA’s new “investment banker” classification (Series 79 exam) only applies to FINRA members;
- Why you should support the M&A Broker Proposal.

# Welcome & Introduction

- Today's Presenters:
  - Jim Cornell, President, Praxiis Business Advisors, Co-Chair, AM&AA's Licensure Initiative
  - Mike Ertel, Managing Director, Legacy M&A Advisors, Co-Chair, AM&AA's Licensure Initiative
  - Shane Hansen, Co-Chair, Broker Dealer & Investment Adviser Practice, Warner Norcross Judd

# The Inconvenient Truth...

...about US & State Securities Laws  
...and how they directly impact  
Business Brokers & M&A Advisors

# The Inconvenient Truth...

- When they facilitate any business sale that involves securities...
- ...most US business brokers and M&A advisors operate in violation of US and state securities laws more often than they generally realize.

# The Inconvenient Truth...

- The sale of a business is always a securities transaction if...
  - It is a “stock” sale vs an “asset” sale;
  - It involves an exchange or issuance of stock in a merger;
  - It involves the issuance or exchange of stock for assets;
  - It involves the sale of stock to an ESOP.
- The sale of a business may be a securities transaction if...
  - It involves an earn-out;
  - It involves a “Seller’s Note.”

# The Inconvenient Truth...

- Securities laws regulate . . .
  - an offer, sale, exchange or issuance of securities.
  - disclosure of material information to the parties.
  - the intermediary who is “effecting” the transaction;
    - Requires broker-dealer registration and regulation;
    - Requires FINRA (f/k/a NASD) membership.

## US and state securities laws say ...

- A “broker” is “any person engaged in the business of effecting transactions in securities for the account of others.”
- Receipt of transaction-based compensation (i.e., a success fee) is a key factor.

# SEC's Broker-Dealer Guide says ...

- Registration is required by finders, business brokers, and others engaged in these activities:
    - Finding investors for “issuers” (entities issuing securities), even in a “consultant” capacity;
    - Finding buyers and sellers of businesses (i.e., activities relating to mergers and acquisitions where securities are involved);
- (<http://www.sec.gov/divisions/marketreg/bdguide.htm>).

# The Inconvenient Truth...

- In any business sale which involves the purchase, sale, issuance, or exchange of stock or other types of securities...
- US & state securities laws apply in addition to state laws like real estate licensing laws.
- **Ignoring these laws can hurt both you and your clients.**

# Potential risks . . .

- Potential statutory rescission rights for the parties.
- Torsiello Capital Partners, LLC v. Sunshine State Holding Corp.
  - New York Supreme Court (April 1, 2008)
  - Broker lost success fee of 3.5 percent and retainer
- Utah letter to M&A and business brokers.
  - [www.securities.utah.gov/business%20broker.pdf](http://www.securities.utah.gov/business%20broker.pdf)
- SEC - Ram Capital Resources, LLC – revenues forfeited.
  - [www.sec.gov/news/digest/2009/dig062209.htm](http://www.sec.gov/news/digest/2009/dig062209.htm)

## Greatest Risk is not from Regulators

- Regulators themselves understand that policing the sale of small- to mid-sized businesses, is rather small potatoes compared to Bernie Madoff's Ponzi scheme, or the near-collapse of AIG, or the international financial markets.
- Regulatory resources are limited
- Reported abuses are rare

## **Greatest Risk is from within the deal itself...**

- Ask yourself on every transaction: “Could an aspiring lawyer or a disgruntled client make a case that this is a securities transaction, and therefore, as an unlicensed intermediary, you are not legally entitled to a fee?”
- As the deal gets larger, and the fee gets larger, your risk becomes greater.

## Under existing securities laws, four basic compliance strategies...

- Handle only pure “asset sale” transactions – no jurisdiction under securities laws if there are no securities involved.
- Structure sell-side engagements per the Country Business letter.
- Individually register with an existing broker-dealer firm to handle the deal – subject to FINRA regulation.
- Register your firm as a broker-dealer (or form a new affiliated firm) – subject to FINRA regulation.

# What should I do NOW?

- Analyze the kinds of deals you do.
- Confer with your own attorneys who are knowledgeable about US & state securities laws.
- Assess the risks to you and your clients.
- Pick which compliance strategy is right for you.
- **Support the M&A Broker Proposal.**

## How does the MAB Proposal help?

- Securities laws still apply, but . . .
- If adopted by the SEC, M&A brokers . . .
  - would not register as a B-D with the SEC;
  - would not become members of FINRA.
- Initial and on-going compliance requirements and costs would be substantially less.
- Broker's contracts would not be void by law.

# Highlights of the MAB Proposal

- **As proposed, an M&A Broker could...**
  - **Broker and advise in M&A transactions;**
    - **Transferring all or part of the business where the buyer is to be actively involved in the business.**
    - **Regardless of the legal structure (stock or assets);**
      - No deal size limitation proposed, but
      - **Could not buy/sell a publicly traded company.**
  - **Represent buyers and sellers (or independent);**
    - Could represent a publicly traded buyer;
    - **Could not advise about issuing publicly traded stock.**
  - **Advise about structuring the deal – stock, assets, ESOP, etc.**

## An M&A Broker could also ...

- Advise about the value of the business (but not the market value of its stock or value in an initial public offering).
- Negotiate the price and terms of the purchase/sale.
- Advertise the business itself for sale (but not its stock).
- Receive cash and/or restricted stock as compensation.
- If permitted by FINRA rules (currently prohibited), receive referral fees from fully registered broker-dealers or PPBs.
- Receive fully-disclosed referral fees from commercial lenders.
- Market itself as a “Registered M&A Broker/Advisor in [States].”

## An M&A Broker could not...

- Participate in any aspect of capital-raising;
  - The PPB proposal would permit limited capital raising.
- Organize groups of investors such as forming an equity fund;
- Advise about or participate in public offerings of securities.
- Deal with a “public shell company” (i.e., publicly traded company without significant business operations).
- Handle or have custody of the funds or securities in a deal.
- Close a transaction on behalf of a client.

# Compliance Requirements under MAB

- A simplified system of state-level regulation:
  - Annual firm registration covering its representatives;
    - Registration in “home state” and notice filing in others
  - Delivery of a disclosure document to prospective clients;
  - Require written engagement and specific business records;
    - A compliance manual addressing securities laws;
    - A “complaint file” for regulatory inspection.
  - Define and prohibit abusive practices in the M&A context.
- Regulators retain authority to inspect securities activities.

# A related proposal would help Main Street business brokers . . .

- Small Business Sales Exemption Rule would:
  - Codify the *Country Business, Inc.* no-action letter into a Commission-adopted rule;
  - Have the legal weight and authority of an SEC rule, not just a staff interpretation;
  - Be easier to understand and apply in practice.
- A similar model rule is proposed to apply CBI at the state level.

# What is the PPB Proposal?

- The Private Placement Broker Proposal was developed by the ABA PPB Task Force and published in 2005.
- The PPB proposal is now believed to be patterned after our MAB Proposal.
- The PPB Proposal would allow limited capital-raising activities from accredited investors without SEC B-D registration or FINRA membership.
- After the MAB Proposal was first presented to the SEC in 2007, the PPB Proposal has generally been under concurrent consideration by the SEC staff.

# If the MAB Proposal is not adopted, what now?

- M&A brokers handling transactions involving stock and other types of debt or equity securities must be registered as a B-D with the SEC and one or more state(s).
- The M&A firm must be a FINRA member.
- Individuals must be registered through their firms with FINRA and one or more states.

# Who or what is FINRA?

- FINRA is a “self-regulatory organization” (“SRO”) of registered broker-dealers.
- FINRA membership is required by federal law if a firm is SEC-registered as a B-D.
- FINRA was formerly called the NASD (National Association of Securities Dealers).
- FINRA’s authority is limited to its member firms and their individual representatives.
- FINRA rules only apply to FINRA members.

## Do FINRA's rules apply to me now?

- **FINRA rules only apply to its members.**
- **FINRA does not decide who must register.**
- **Neither the SEC nor FINRA enforce its rules against non-members.**

# What does FINRA membership mean?

- FINRA and securities regulation is complex;
  - A comparative summary on the AM&AA website: <http://www.amaaonline.com/advocacy>

Description	Fully-registered Broker-Dealer	Proposed M&A Broker	Business Broker ( <i>Country Business Letter</i> )
Permitted securities-related activities	<ul style="list-style-type: none"> <li>■ All activities permitted subject to related requirements and prohibitions listed below;</li> <li>■ Activities are generally restricted by the ED's business plan as submitted to FINRA in the new membership process and the FINRA membership agreement signed when membership is approved, unless and until those documents are amended by later application.</li> </ul>	<p>Limited to the following and subject to prohibitions listed below:</p> <ul style="list-style-type: none"> <li>■ Participation in the purchase or sale of a business, a line of business, or a controlling interest if the buyer is actively involved in its management or operation; and</li> <li>■ Assist the seller or buyer with financial modeling and analysis of the business; and</li> <li>■ All asset sale BB activities.</li> </ul>	<ul style="list-style-type: none"> <li>■ If the transaction turns into a stock sale, the activities must be limited to:               <ul style="list-style-type: none"> <li>▪ Transmitting documents between the parties;</li> <li>▪ Valuing the assets of the business as a going concern;</li> <li>▪ Providing the seller with administrative support; and</li> <li>▪ Assisting seller in preparing financial statements;</li> </ul> </li> <li>■ Assisting with commercial loan applications</li> </ul>

# What's the buzz about the Series 79?

- FINRA recently adopted a new category for individuals registered with its member firms:
  - Limited Representative – Investment Banker;
  - Series 79 Investment Banking Exam to qualify;
  - Effective November 2, 2009.
- This is only one of many FINRA categories and related qualifications for individuals.

## Why the buzz?

- The new “investment banker” classification brings more focus to the question – when must an M&A broker be securities licensed?
- Many brokers mistakenly reacted to the new Series 79 exam as though this was the first time their activities have come under SEC and FINRA jurisdiction.

# Did the Series 79 derail the MAB Proposal?

- **NO!**
- Changes in FINRA's categories and qualifications for representatives have **NO BEARING** on whether a firm must be registered as a B-D.
- This is a FINRA rule, **NOT** an SEC rule.
- SEC oversight of FINRA's rulemaking is entirely separate from the SEC's own rulemaking.
- The Series 79 exam simply replaces the Series 7 and Series 62 (Corporate Securities) exams.

## Did the MAB Proposal motivate FINRA to create the Series 79?

- No.
- We understand that the Series 79 was requested by multi-national investment banking firms so their U.S., U.K. and Canadian staffs do not have to pass the Series 7 exam.
- Canadian and U.K. representatives can be grandfathered into the new classification.

## Did this Series 79 come as a surprise?

- No.
- When the SEC published FINRA's rule for public comment, AM&AA, ICBC, M&A Source, and MBBI submitted comments.
- We agreed it was a good idea – the exam content is more relevant – but we also asked the SEC to adopt the MAB Proposals.

## SEC's final order on Series 79 acknowledges MAB proposal is under active consideration...

- The SEC order approving FINRA's rule stated:  
“Four of the six commenters raised the issue of a proposal previously made to the Division of Trading & Markets (the “Division”) that would create a federal registration exemption and simplified system of regulation for merger and acquisition intermediaries. See AM&AA Letter; ICBC Letter; M&A Source Letter; MBBI Letter. The proposal is not germane to this proposed rule change and is being considered separately by the Division.” [Emphasis added]

## What's the Bottom Line on Series 79?

- **FINRA's new rule does not change federal and state securities laws.**
- **The scope and jurisdiction of the SEC, states, and FINRA are unchanged.**
- **This is only a reclassification of representatives by FINRA and a new qualification exam.**

## OK, so what activities are covered by this new category?

- The “Investment banker” classification covers:
  - advising on or facilitating debt or equity securities offerings through a private placement or a public offering, including but not limited to origination, underwriting, marketing, structuring, syndication, and pricing of such securities and managing the allocation and stabilization activities of such offerings, or

## The covered activities also include . . .

- More relevant to you, it also covers:
  - advising on or facilitating mergers and acquisitions, tender offers, financial restructurings, **asset sales**, divestitures or other corporate reorganizations or business combination transactions, including but not limited to rendering a fairness, solvency or similar opinion.

## Why are “Asset Sales” included as a regulated activity under Series 79?

- Upon learning that "asset sales" are included in the list of regulated activities under the new rule, many business brokers and M&A advisors have mistakenly concluded that the SEC and FINRA are "breaking new ground" that was previously the sole province of the states, and/or state real estate law.

## Why are “Asset Sales” included?

- Examining FINRA’s Series 79 exam study guide suggests that the reference to “asset sales” pertains to transactions where the Buyer issues stock or other securities in exchange of the Seller’s assets, not purely asset sales that do not involve any securities.
- Asset sales for cash consideration are generally exempt from securities laws and FINRA jurisdiction if conducted outside of the registered B-D firm.

## The Bottom Line re: “Asset Sales” ...

- FINRA jurisdiction does extend to all activities that are conducted inside a member B-D.
- All securities transactions – e.g., stock sales – must be conducted through the B-D.
- Activities not related to securities – e.g., purely asset sales – may be conducted outside the firm and are monitored by B-Ds as “outside business activities” of a firm’s individual representatives.

## The Bottom Line re: Series 79...

- FINRA's new Series 79 exam is not breaking new regulatory ground.
- FINRA's rule has no bearing on who should be registered as a B-D.
- If you, or your firm, handle securities transactions described in FINRA's new rule, you should have been registered all along.

## So, where does the MAB Proposal stand with the SEC?

- All indications are that our proposal is very much alive and well, and well received.
- The meltdown of the U.S. economy, the failures of major securities firms like Lehman and Bear Stearns, and the Madoff scandal (among others) have consumed the SEC's attention for the last year.
- Work on the proposal has continued at the staff level; we are actively seeking the Commissioners' attention through letters and proposed meetings.

## Where do we stand with the states?

- NASAA's incoming President and others among NASAA's leadership are strong supporters.
  - The proposal was discussed at the annual SEC-NASAA meeting in Washington DC in May 2009.
  - NASAA's September Annual Meeting features a panel discussion – Monitoring the Middlemen: Enhancing the Regulation of Third Party Finders
  - The panel, organized and hosted by Tanya Solov (Illinois), includes Hugh Makens, co-counsel on the MAB proposal, and SEC staff attorney, Joanne Rutkowski.

# What Can I Do To Support the Proposal and the Campaign for Clarity?

- Once the M&A Broker proposal is released for public comment – first by the SEC, and later by NASAA -- we may need you/ your firm/ your professional association to write a letter/e-mail in support of this proposal.
- Once NASAA recommends the M&A Broker proposal as a model rule for all states and jurisdictions, we may need you/ your firm/ your professional association to write letters/e-mails to your home state regulators in support of this proposal.
- We will advise you in plenty of time when these windows of opportunity open.

## What More Can I Do . . .

- Right now we also need your financial support!
- To date this effort has been totally funded by voluntary contributions from individuals, firms and professional associations who recognize the need to clarify and – if possible – simplify the securities laws that can directly affect business brokers and M&A advisors.

# Partial List of Contributors

- Alliance of Merger & Acquisition Advisors (AM&AA)
- International Network of M&A Partners (IMAP)
- Alliance for Corporate Wealth (ACW)
- Midwest Business Brokers & Intermediaries (MBBI)
- International Business Brokers Association (IBBA)
- M&A Source
- Business Brokers of Florida (BBF)
- Colorado Association of Business Intermediaries (CABI)
- Mid Atlantic Business Intermediaries Association (MABIA)
- Texas Association of Business Brokers (TABB)
- California Association of Business Brokers (CABB)
- Institute of Certified Business Counselors (ICBC)
- Georgia Association of Business Brokers (GABB)
- Numerous Individuals and Firms

## What More Can I Do . . .

- In addition to the funds which have already been raised, we estimate that we need to raise an additional \$150,000 to complete this project.
- Everyone registered for this webinar will receive a pledge card.
- Contribute your fair share.

## AMAA Marketplace Leadership Pledge Card

- Yes, I want to support AMAA's Marketplace Leadership Licensure Initiative.
  - Please accept my enclosed contribution for \$\_\_\_\_\_.
  - Please accept my pledge for \$\_\_\_\_\_ to be paid on or before December 31, 2009.
  - Please accept my pledge for \$\_\_\_\_\_ to be paid on or before December 31, 2010.
  - Please accept my pledge for \$\_\_\_\_\_ to be paid from my proceeds of my next closing.

\_\_\_\_\_  
Signature

\_\_\_\_\_  
Date

**Make Your Contribution Payable To:  
And Mail Your Contribution/ Pledge Card To:**

*The Marketplace Leadership Fund  
C/O AM&AA  
200 E Randolph Street, 24<sup>th</sup> Floor  
Chicago, IL 60601*



**Questions?**



# What is the definition of a "security?"

- ...any note, stock, treasury stock, security future, bond, debenture, certificate of interest or participation in any profit-sharing agreement... preorganization certificate or subscription, transferable share, investment contract... any put, call, straddle, option... or in general, any instrument commonly known as a "security"...
- SEC and most states treat LLC membership interests as securities
  - Expressly included in the "securities" definition in some states
  - Other states apply "investment contract," "profit-sharing agreement," "risk capital analysis," or "characteristics of stock" tests

# When is a “seller’s note” a security?

- A “note” is in the statutory definition of a “security”
- A “note” is presumed to be a “security” unless it bears strong “family resemblance” to instruments held not to be securities
  - Reves vs. Ernst & Young, U.S. Supreme Court (1990)
- Case law is highly fact-specific and is not consistent
  - See *Promissory Notes as Securities*, 39 ALR Fed 357 (2004)
  - E.g., In the Matter of Gebhart, 2006 SEC LEXIS 93 (1/18/06)
  - See SEC Release No. 33-4412 (1961)
- State securities regulators also presume that a “note” is a security
  - [http://www.nasaa.org/Investor\\_Education/Investor\\_Alerts\\_Tips/1693.cfm](http://www.nasaa.org/Investor_Education/Investor_Alerts_Tips/1693.cfm)

# What are some “red flags” that a seller’s note might be a security?

- When one or more of the following factors exist:
  - The note’s term is for more than 90 days (i.e., not “short term”)
  - The notes are freely transferable (i.e., negotiable, assignable)
  - The note holder was not, and/or is not, active in the business for the term of the note
  - There are “equity kickers,” “shared appreciation features,” adjustable rates, or terms that affect the risks to the note holder
  - The note is not secured by collateral (or perhaps under-secured)
  - The note represents an investment to the holder
  - There are multiple note holders (implying a “plan of distribution”)
  - Convertibility and other features (e.g., puts, calls, options)



**Questions?**



# More Information...

- SEC registration and regulation
  - Guide to Broker-Dealer Registration  
<http://www.sec.gov/divisions/marketreg/bdguide.htm>
- FINRA membership and regulation
  - FINRA “How to Become a Member” Guide  
<http://www.finra.org/RegistrationQualifications/MemberFirms/index.htm>
- State registration/licensing  
[http://www.nasaa.org/industry\\_regulatory\\_resources/broker\\_dealers/520.cfm](http://www.nasaa.org/industry_regulatory_resources/broker_dealers/520.cfm)
- Alliance of Merger & Acquisition Advisors
  - Latest SEC/Licensure News  
<http://www.amaaonline.com>

## A closer look at the new Series 79 exam ...

- Individuals registered with a B-D as an “investment banker” must be qualified . . .
  - Rule becomes effective November 2, 2009
  - Six-month phase-in period for current holders of the Series 7 exam or the United Kingdom or Canadian equivalent exams can opt to be grandfathered-in
  - After May 3, 2010, new registrants must take the Series 79 exam

## A closer look at the new Series 79 exam ...

- 175 multiple choice questions in 5 hours
- Test questions cover four major functions:

Section	Description	Number of Questions
1	Collection, Analysis and Evaluation of Data	75
2	Underwriting/New Financing Transactions, Types of Offerings and Registration Of Securities	43
3	Mergers and Acquisitions, Tender Offers and Financial Restructuring Transactions	34
4	General Securities Industry Regulations	23
	Total	175

## A closer look at the new Series 79 exam ...

- FINRA Regulatory Notice 09-41:  
[http://finra.complinet.com/en/display/display\\_main.html?rbid=2403&element\\_id=8581](http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=8581)
- FINRA exam study guide:  
<http://www.finra.org/Industry/Compliance/Registration/QualificationsExams/RegisteredReps/P011051>

# AM&AA Webinar

## We hope you learned about . . .

- How the M&A Broker Proposal could bring you into compliance with federal and state securities laws
- Why FINRA’s new “investment banker” classification (Series 79 exam) only applies to FINRA members
- Why you should support the M&A Broker Proposal