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Submitted as counsel for and on behalf of the

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With respect to H.R. 2274
The Small Business Mergers, Acquisitions,
Sales, and Brokerage Simplification Act of 2013

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Introduction

Chairman Garrett, Ranking Member Maloney, members of the Capital Markets Subcommittee, thank you for this opportunity to explain how and why today's "one size fits all" system of regulating securities broker-dealers adversely impacts and unnecessarily increases the costs that business owners incur to sell, buy, or grow their small and mid-sized businesses through privately negotiated mergers, acquisitions, business combinations, and sale transactions.[1] This legislation represents the culmination of more than six years' effort to work cooperatively with the staff of the Securities and Exchange Commission ("*SEC*" or "*Commission*"), through its Division of Trading and Markets, and with state securities regulators through the North American Securities Administrators Association ("*NASAA*"), to craft a regulatory solution. As quoted below, even the SEC recognizes the need to address this small business issue, but it has been unable to make this a rulemaking priority and, in the absence of a Congressional mandate, is unlikely to do so any time soon.

The purpose of the Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification Act of 2013, H.R. 2274 (the "*Small Business Brokerage Act*"), is to appropriately scale federal regulation of securities broker-dealers with respect to privately negotiated business sales, mergers, and acquisitions ("*M&A*"). It would enhance public protections for business sellers and buyers by clarifying and creating relevant regulatory requirements while addressing these critically important small business considerations:

- An estimated $10 trillion of privately owned businesses will be sold or closed as baby boomers retire.
- Jobs are preserved and created when new entrepreneurs and other companies acquire and grow existing businesses.
- Business brokers play a critical role in facilitating private business mergers, acquisitions, and sales.

[1] This written statement is submitted by Shane B. Hansen as legal counsel for the Alliance of Merger & Acquisition Advisors ("*AM&AA*"), a national professional association of more than 900 M&A brokers and associated members headquartered in Chicago, Illinois. More information about the AM&AA is available on its website at http://www.amaaonline.com/. This effort is supported by the International Association of Business Brokers ("*IBBA*"), including the M&A Source, a national professional association of business brokers headquartered at 3525 Piedmont Road, Building Five, Suite 300, Atlanta, Georgia, 30305. More information about the IBBA and the M&A Source is available on their websites at: http://www.ibba.org/ and http://www.masource.org/. Fourteen regional professional associations of M&A and business brokers also support this effort.

- Simplified and appropriately scaled regulation of business brokerage services will reduce costs and better protect business owners.

Public Policy

The public policy considerations supporting this legislation began in 2005 with the American Bar Association, Business Law Section, *Report and Recommendations of the Private Placement Broker-Dealer Task Force*, available on the SEC website at www.sec.gov/info/smallbus/2009gbforum/abareport062005.pdf. A similar recommendation was made the next year in *The Final Report of the Advisory Committee [to the SEC] on Smaller Public Companies*, also available on the SEC's website at www.sec.gov/info/smallbus/acspc/acspc-finalreport.pdf. Following the issuance of these independent and unbiased reports, working drafts of proposed rules to accomplish these recommendations were developed by the Alliance of Merger & Acquisition Advisors ("*AM&AA*"), with the support of the International Association of Business Brokers ("*IBBA*"), and submitted to the SEC and NASAA in 2007 and 2008. A proposal to appropriately scale federal regulation of M&A intermediaries and business brokers ("*M&A brokers*") has been among the top recommendations in the 2006, 2007, 2008, 2009, 2010, and 2011 Government-Industry Forum on Small Business Capital Formation hosted by the SEC (http://sec.gov/info/smallbus/sbforum.shtml). This topic was not on the 2012 agenda, which is set by the SEC. The SEC has been studying these issues, as acknowledged by former SEC Chairman Schapiro, but has not engaged in rulemaking.

In December 2011, a bipartisan group of eight Congressmen wrote to then SEC Chairman Schapiro asking about the status of the recommendations from past SEC-Government Small Business Capital Formation Forums. Chairman Schapiro's response to the Congressmen, attached to this statement, was encouraging. She gave the following response to a similar "question for the record" following her December 2011 Senate testimony:

> The staff of the Division of Trading and Markets, which is primarily responsible for administering the regulation of brokers and dealers, is analyzing the SEC's rules and regulations that apply to business brokers. The Division staff is developing options that it could recommend that the Commission consider to revise those regulations in light of the role that business brokers play in the purchase, sale, exchange or transfer of the ownership of privately owned businesses. The Division staff is also revisiting existing guidance about whether certain business brokers must be registered with the SEC as brokers in order to determine whether the Commission or the staff should provide further guidance in this area. We are mindful of the importance of considering both the burdens on small businesses' capital formation arising from our regulatory requirements and the benefits of those requirements to investors and other market participants.

Despite this encouragement, in more than six years the SEC has been unable to make this small business issue a rulemaking priority and will be unlikely to do so without a Congressional directive. A solution is urgently needed as more baby boomers retire, many of whom must choose between finding a buyer or closing their businesses. More jobs would be preserved and created by facilitating business mergers, acquisitions, and business combinations of small and mid-sized companies at a lower cost for professional services. Let me emphasize, these *are*

not publicly traded companies, but these *are* the companies largely responsible for innovation and fueling economic growth in the U.S.

Business Context

Each of you has in your district hundreds, and more likely several thousands, of business owners who, sooner or later, want to sell their small and mid-sized businesses. They will want and need professional assistance preparing their business for the sale, valuing their business, talking about potential human resource issues when ownership and control of their business is changing, marketing the business, finding and screening potential buyers, talking about possible sale transaction structures, preparing for prospective buyers' due diligence, assessing buyers' competing offers, and consulting on a wide range commonly recurring business transition issues. The sellers will also be advised by their lawyers and accountants performing their customary legal, tax, and account services, but whose training, experience, and skills typically do not include the consulting services previously mentioned.

Similarly, back in your districts, there are hundreds, and more likely several thousands, of entrepreneurs committed to owning their own business, as well as larger companies wanting to grow by adding product lines, production capacity, intellectual property, or expanding geographically. These potential buyers want and need professional assistance finding and screening potential sellers; assisting with and assessing their due diligence investigation into each potential seller's business; advising about possible purchase terms and conditions; anticipating issues with staffing, intellectual property, and other commonly recurring business transition issues; financial modeling and advising about possible financing alternatives and their impact on profitability; and working with the lawyers and accountants employed by the buyers for their customary legal, tax, and accounting services. Sometimes these buyers are sophisticated and well-funded venture capital or private equity groups "in the business" of buying start-up and smaller companies.

These are the kinds professional services provided to small and mid-sized business sellers and buyers by M&A brokers. M&A brokers and their firms are themselves small businesses, ranging in size from solo practioners to perhaps a dozen or more professionals and support staff. M&A brokers come from diverse business and financial backgrounds, such as commercial real estate, accounting, law, finance, and business management, and many have extensive study, training, experience, and professional education in a broad range of business management consulting, human resources, financial, accounting, and tax matters. You likely have hundreds of M&A brokers in your districts as they can be found in both small towns and urban centers. Typically, lawyers and accountants do not provide the kinds of business marketing and consulting services just described.

Typically, small and mid-sized businesses organically build wealth through many years of hard work, innovation, and jobs creation. Very small businesses have an "owner life cycle" that is affected by the owners' death, sickness, burnout, or other economic opportunities (e.g., a sale). At this conclusion of the business ownership lifecycle, the business either continues under new owners or it closes, ending its economic contribution, and the employment and associated commerce it has created for the communities where it has operated. Mid-sized companies are similarly, though typically not as immediately, impacted by the owners' or managements' changing personal circumstances. M&A brokers are the bridge that enables many small

and mid-sized businesses to continue with fresh energy and momentum. M&A brokers help protect the wealth accumulated by the exiting owner through a well-advised sale, while enabling new owners to maintain the economic viability, jobs and commerce that the exiting owner had created, most often bringing fresh ideas, new energy, and commitments to grow and improve.

Capital formation, businesses grown and saved, and jobs created and saved by small and mid-sized businesses are all facilitated when sellers and buyers can obtain cost-effective professional advice and assistance with the transfer of ownership through stock sales, mergers, and other business combinations. For example, the acquisition of one business by another enables the combined business to expand and accumulate investors' capital in a more diversified, often financially stronger, business enterprise. Even when a business seller receives the buyer's cash, instead of the buyer's stock, that cash is often reinvested in another business enterprise.

Today, federal securities laws and rules regulate "Main Street" M&A brokers handling privately negotiated "sale of business" transactions the same way as "Wall Street" investment bankers handling transactions involving publicly traded companies. Most of those compliance costs must be passed on to the business buyers and sellers in order for the M&A brokers to stay in business, thus unnecessarily making their professional services unaffordable. These compliance-driven costs are unduly high in light of the inherent safeguards protecting the buyers and sellers in these privately negotiated transactions.

These types of M&A transactions are negotiated between sellers and buyers by their lawyers and M&A brokers. The parties negotiate and the lawyers document their representations, warranties, covenants, rights, and remedies. Buyers conduct extensive due diligence on the sellers' businesses. Buyers will actively own, operate, and directly manage their business entities following the closing; they are not unsophisticated passive investors. These are vastly different circumstances than investment bankers handling M&A transactions involving public companies, or passive investors relying upon information provided through SEC filings. These sellers and buyers do not rely upon federal or state securities laws for their protection; rather, they rely upon the fully negotiated transaction-related agreements created by their lawyers.

Legal Background

Very small business sale transactions are commonly accomplished through the sale of the business's assets in exchange for cash, which is generally not subject to securities regulation. However, even the sale of business assets can become a securities transaction under some circumstances if it involves an "earn-out" or the buyer's giving its promissory note to the seller, each of which may be regarded as "securities" under federal and state securities laws. Moreover, when for a variety of reasons the ownership of a privately held business is transferred by means of the purchase, sale, exchange, recapitalization, repurchase, issuance, merger, consolidation, or other business combinations involving stock or other securities, then federal and one or more state securities laws apply[2] to the parties, the transaction, and regulate the transaction-related activities of the M&A broker.

[2] *See, e.g.*, SEC Rule 145, *Reclassification of Securities, Mergers, Consolidations and Acquisitions of Assets*.

Since the U.S. Supreme Court's opinion in *Landreth Timber Co. v. Landreth*,[3] the federal securities laws have been applied to the offer and sale of a business regardless of whether the transaction involves the sale of one or all of the outstanding shares of a company's securities. When an intermediary is brokering the sale of businesses involving securities, the intermediary often comes within the broad definition of a "broker" under the Securities Exchange Act of 1934, as amended ("*Exchange Act*"). The Exchange Act generally requires the intermediary to be registered and regulated as a "broker-dealer" by the SEC and to be a member of, and regulated by, the Financial Industry Regulatory Authority ("*FINRA*"). Offering-related registration exemptions (*e.g.*, SEC Regulation D) do not exempt broker registration requirements. State securities laws impose registration and regulatory requirements on brokers, dealers, or broker-dealers as those terms are similarly defined. State real estate and business brokerage licensing laws also apply to these activities, creating multiple layers of initial and on-going regulatory requirements, professional qualifications, and compliance-related costs for M&A brokers.

"Broker" Status

Section 3(a)(4)(A) of the Exchange Act defines a "broker" broadly as "any person engaged in the business of effecting transactions in securities for the account of others". Section 15(a)(1) of the Exchange Act provides, in pertinent part, that:

> It shall be unlawful for any broker or dealer . . . to make use of the mails or any means or instrumentality of interstate commerce to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security . . . unless such broker or dealer is registered in accordance with subsection (b) of this section.

15 U.S.C. § 78o. This proscriptive language applies not only to either purchases or sales, but also to solicitations intended to result in purchases or sales whether or not a transaction ultimately occurs.

The SEC's *Guide to Broker-Dealer Registration*[4] provides guidance about and various examples of "broker" status. According to the *Guide*, each of the following individuals and businesses may need to register as a broker, depending on a number of factors:

- "finders," "business brokers," and other individuals or entities that engage in the following activities:
  - Finding investors or customers for, making referrals to, or splitting commissions with registered broker-dealers, investment companies (or mutual funds, including hedge funds) or other securities intermediaries;
  - Finding investment banking clients for registered broker-dealers;
  - Finding investors for "issuers" (entities issuing securities), even in a "consultant" capacity;
  - Engaging in, or finding investors for, venture capital or "angel" financings, including private placements;

[3] *Landreth Timber Co. v. Landreth*, 471 U.S. 681; 105 S. Ct. 2297 (May 28, 1985).

[4] Available on the SEC's website at http://www.sec.gov/divisions/marketreg/bdguide.htm#II.

- Finding buyers and sellers of businesses (*i.e.*, activities relating to mergers and acquisitions where securities are involved);

* * *

The SEC looks at the activities that the intermediary actually performs and the *Guide* lists some of the questions that, in the staff's view, bear upon whether an intermediary is acting as a broker:

- Do you participate in important parts of a securities transaction, including solicitation, negotiation, or execution of the transaction?

- Does your compensation for participation in the transaction depend upon, or is it related to, the outcome or size of the transaction or deal? Do you receive trailing commissions, such as 12b-1 fees? Do you receive any other transaction-related compensation?

- Are you otherwise engaged in the business of effecting or facilitating securities transactions?

- Do you handle the securities or funds of others in connection with securities transactions?

In the staff's view, a "yes" answer to *any* of these questions indicates the intermediary may need to register as a broker (which encompasses registration as a dealer and hence is commonly referred to as a "broker-dealer").[5] SEC registration as a broker also requires membership in FINRA. A similar analysis is applied under state securities laws, which all define "broker" in essentially the same terms.

In recent years, the SEC's application of these criteria through various enforcement cases and no-action letters has focused upon the presence of transaction-based compensation—a "hallmark of broker-dealer activity"[6]. Transaction-based compensation, including success fees and commissions, is generally contingent on the outcome and is often measured by the consideration exchanged in the transaction. This type of incentive compensation creates inherent conflicts of interest that the SEC considers to be a paramount concern in protecting investors. Other forms of compensation may satisfy the "engaged in the business" element in the "broker" definition, but typically carry somewhat less weight when there is no incentive or "salesman's stake" tied to the transaction's outcome (thus helping lawyers and accountants to distinguish their role and fees in an M&A transaction). While old SEC no-action letters implied that a mere

[5] For additional factors relevant to private equity funds, venture capital funds, business development companies, and similar issuers *see*, Speech, *A Few Observations in the Private Fund Space*, , David W. Blass, Chief Counsel, SEC Division of Trading and Markets (April 5, 2013), available at: http://www.sec.gov/news/speech/2013/spch040513dwg.htm (the "Blass Speech").

[6] *See Order Exempting the Federal Reserve Bank of New York, Maiden Lane LLC and the Maiden Lane Commercial Mortgage Backed Securities Trust 2008-1 from Broker-Dealer Registration*, SEC Release No. 34-61884 (April 9, 2010). *See also, 1st Global, Inc*., 2001 SEC No-Act. LEXIS 557 (May 7, 2001) (reiterating the staff's position that "the receipt of securities commissions or other transaction related [sic] compensation is a key factor in determining whether a person or an entity is acting as a broker-dealer. Absent an exemption, an entity that receives commissions or other transaction-related compensation in connection with securities-based activities that fall within the definition of 'broker' or 'dealer'... generally is required to register as a broker-dealer." (internal citations omitted)).

introduction of the parties might be permissible[7], more recent no-action letters express the SEC staff's skepticism about a broader scope of involvement or the regularity of participation in capital-raising activities being present in the fact patterns presented (*e.g.*, actively soliciting prospective investors, transmitting offering documents, or recommending an offering).[8] For example, seeking and introducing prospective investors to different issuers in exchange for a finder's fee may be deemed to be engaging in the business of a broker.[9] The SEC staff has publicly stated that the oft-cited ***Paul Anka*** no-action letter[10] is to be limited to its facts[11]—an issuer's use of a singer's rolodex without any contact between the Canadian singer and potential investors.

While the SEC places considerable weight on the presence of transaction-based compensation, a number of federal district court decisions have articulated other factors to be considered in analyzing key aspects of the definition of "broker". In ***SEC v. Kenneth Kramer***[12] the court criticized the SEC for failing to provide sufficient proofs with respect to factors beyond transaction-based compensation. The ***Kramer*** opinion summarized various factors identified in prior court decisions:

> Because the Exchange Act defines neither "effecting transactions" nor "engag[ing] in the business," an array of factors determines whether a person qualifies as a broker under Section 15(a). The most frequently cited factors, identified in ***S.E.C. v. Hansen,*** consist of whether a person (1) works as an employee of the issuer, (2) receives a commission rather than a salary, (3) sells or earlier sold the securities of another issuer, (4) participates in negotiations between the issuer and an investor, (5) provides either advice or a valuation as to the merit of an investment, and (6) actively (rather than passively) finds investors. See also ***Cornhusker Energy Lexington, LLC v. Prospect St. Ventures*** (Bataillon, J.) (identifying as evidence of broker activity a person's "analyzing the financial needs of an issuer," "recommending or designing financing methods," discussing "details of securities transactions," and recommending an investment); ***S.E.C. v. Margolin*** (Leisure, J.) (finding evidence of "brokerage activity" in the defendant's "receiving transaction-based compensation, advertising for clients, and possessing client funds and securities.").
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> However, "[t]he factors articulated in Hansen . . . [a]re not designed to be exclusive," and some factors (i.e., those factors typically associated with broker activity) appear more indicative of broker conduct than others. For example, ***S.E.C. v. Bravata*** (Lawson, J.), describes "[t]he most important factor in determining whether an individual or entity is a broker" as the "regularity of participa-

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[7] *See, e.g.*, *Mike Bantuveris*, 1975 SEC No-Act. LEXIS 2158 (1975).

[8] *See, e.g.*, *Brumberg, Mackey & Wall*, 2010 SEC No-Act. LEXIS 406 (2010) a law firm could not introduce its issuer clients to potential investor clients in exchange for a finder's fee.

[9] For a summary of SEC no-action letters, *see the Report and Recommendations of the Private Placement Broker-Dealer Task Force*, Business Law Section, American Bar Association, 60 ***Business Lawyer*** 959-1028 (2005), and available at http://sec.gov/info/smallbus/2009gbforum/abareport062005.pdf (the "ABA PPB Task Force Report").

[10] *Paul Anka*, 1991 SEC No-Act LEXIS 925 (1991).

[11] SEC 2008 Small Business Capital Formation Forum Transcript, Private Placement and M&A Brokers Panel (Nov. 20, 2008).

[12] *SEC v. Kenneth Kramer*, 778 F. Supp. 2d 1320, 2011 U.S. Dist. LEXIS 38968 (M.D.Fla. 2011). The SEC's initial appeal of the decision was dismissed by the court because final judgments had not yet been entered as to all parties. Final judgments were entered on February 22, 2013.

> tion in securities transactions at key points in the chain of distribution." [S]ee also *S.E.C. v. Kenton Capital, Ltd.* (Kollar-Kotelly, J.) (describing "regularity of participation" as one of the primary indicia of "engag[ing] in the business"). [48] Cornhusker describes "transaction-based compensation" as "one of the hallmarks of being a broker-dealer." (stating that "[t]he underlying concern has been that transaction-based compensation represents a potential incentive for abusive sales practices that registration is intended to regulate and prevent."). In other words, transaction-based compensation is the hallmark of a salesman. By contrast, a person's recommending a particular investment or participating in a negotiation typically occurs in an array of different commercial activities and professional pursuits, including brokering.

Kramer, p. 1334-1335(internal citations omitted). The court's contrasting statement above fails to note that giving investment advice for compensation usually requires registration and regulation as an "investment adviser" under federal and state securities laws.

Importantly, the SEC has granted limited relief to M&A intermediaries and business brokers who may meet the "broker" definition through a small number of no-action letters, notably including *Country Business, Inc.*, *Victoria Bancroft*, and *International Business Exchange Corp.*[13] These no-action letters include a number of significant factual limitations but they are commonly relied upon by business brokers to conduct their activities without federal broker registration (states may or may not follow the SEC staff's guidance). For example, among the nine enumerated factual predicates in the *Country Business, Inc.* letter, the entire business must be sold, that business must meet the "small business" definition under the Small Business Administration's standards[14], and the intermediary may not talk about securities-related transaction structures (e.g., a purchase of stock versus a sale of assets). The SEC has also denied no-action relief in similar M&A contexts but without providing meaningful explanations,[15] perhaps reflecting the lack of factual detail in the requestors' letters.

If asked, many states may follow the SEC's no-action letter guidance, even though it is not binding on them; some states may impose their own conditions, while others may not grant any relief. State regulators are often unfamiliar with how the activities of an M&A broker differ from those of investment banking or retail broker-dealers. Some states impose specific registration and related requirements on all types of finders.[16] Some states have broker-dealer registration exemptions when the owner/investor qualifies as an "institutional investor" as the term is defined in their blue sky law or rules.[17] California exempts by rule "any person who effects transactions in securities in this state only in connection with mergers, consolidations or purchases of corporate assets, and who does not receive, transmit, or hold for customers any

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[13] *Country Business, Inc.*, 2006 SEC No-Act. LEXIS 669 (2006); *Victoria Bancroft*, 1987 SEC No-Act. LEXIS 2517 (1987); and *International Business Exchange Corp*. 1986 SEC No-Act. LEXIS 3065 (1986).

[14] Available on the Small Business Administration's website at: http://www.sba.gov/content/table-small-business-size-standards.

[15] *Hallmark Capital Corporation*, 2007 SEC No-Act. LEXIS 509 (2007); and *Mike Bantuveris*, 1975 SEC No-Act LEXIS 2158 (1975).

[16] *See, e.g.*, Texas Administrative Code, Title 7, Chapter 115, Section 115.11, *Finder registration and activities*; and Administrative Rules of South Dakota, Article 20:08, Section 20:08:03:17, *Finders*.

[17] *See, e.g.*, Section 401(b)(1)(C) of the Uniform Securities Act of 2002.

funds or securities in connection with such transactions", generally referred to as a "merger and acquisition specialist".[18]

Today's "One-sized" Regulatory System

The burdens and costs of initial broker-dealer registration and on-going compliance with current SEC and FINRA requirements are substantial. Initial set-up and compliance-related costs often exceed $150,000. On-going compliance costs often exceed $75,000 per year. Applying for and obtaining FINRA membership typically takes six to nine months, and frequently longer. There are competency exams that test on substantive material totally irrelevant to the professional knowledge base required to advise about M&A transactions[19]. Accrual-based GAAP accounting is required and minimum net capital must be maintained at all times regardless of the ebbs and flows of transaction-related income and expenses. Monthly or quarterly financial reporting is required prepared by specially qualified financial and operations principals. Annually audited balance sheets and related schedules and attestations must be filed with the SEC and FINRA. Anti-money laundering programs, procedures, and independent third-party AML testing are required, even though M&A brokers rarely, if ever, handle the parties' funds or securities. Membership in the Securities Investors Protection Corporation is required and membership fees are assessed, even though M&A brokers do not handle securities. The SEC, FINRA, and the states charge the firm annual registration fees and membership assessments based on the firm's gross revenues, as well as annual registration fees for each registered representative.

The body of existing SEC and FINRA rules impose significant requirements affecting every aspect of a broker-dealer's business ownership, staffing, marketing, operations, and recordkeeping. These rules have become highly complex over the years in response to, among other things, evolving financial markets, major securities frauds, national financial crises, and perceived regulatory gaps. This "one size fits all" body of regulation has been written largely to address investor protection in the context of retail brokerage services and investment banking services for publicly traded companies. Most of the SEC's and FINRA's rules and related guidance require "translation" when applied in the M&A and business brokerage context. For example, FINRA's "know your customer" and "suitability" rules must be applied to "customers" in the context of transactions between business buyers and sellers. Even the basic registration application, Form BD, does not explicitly identify either M&A or investment banking activities as a category of regulated activities—in Item 12 of the form the registrant must mark "Private placements of securities", "Other", and explain its activities in a supporting schedule. Newly released regulatory guidance comes from FINRA weekly and must be monitored for changes pertinent to the narrowly focused activities of M&A brokers.

All of this complexity and cost disproportionately impacts small and mid-sized businesses and the professional intermediaries who serve them because they typically handle smaller transactions that generate smaller success fees, so they are less able to spread these fixed costs over multiple transactions. The commitment of management and staff time, as well as largely fixed compliance-related costs, are annually required to maintain registered status regard-

[18] *See* 10 CCR Section 260.204.5, 10 CA ADC Section 260.204.5, *Merger and Acquisition Specialists*, adopted in 1974.

[19] Content outlines for FINRA's examinations are available on its website at http://www.finra.org/Industry/Compliance/Registration/QualificationsExams/Qualifications/p011051.

less of the number of securities-regulated business sale transactions closed by the M&A broker in any given year, which for smaller firms may be one or perhaps two per year since smaller M&A transactions are often cash-for-assets sales not regulated under securities laws. Substantially all of these costs are necessarily passed on to the business sellers and buyers who use the registered broker-dealer's services.

These high costs drive some business sellers and buyers to engage unregistered M&A brokers if they want professional assistance with their transactions. Accordingly, a very high percentage of M&A brokers are not registered with the SEC and so, technically, are violating the registration requirements in federal securities laws today. Their registration violations may put their clients' transactions at risk of being rescinded if the post-closing business does not run as hoped or is run into the ground by the buyer. Registration violations put the M&A brokers at risk for regulatory enforcement and sanctions, as well as their livelihood, even though today's registration and body of regulation is largely irrelevant to their services and does little to protect business sellers and buyers, who protect themselves through their negotiated rights and remedies in M&A and stock purchase agreements.

Regulatory Reform

"Right-sizing" federal regulation of M&A brokers and finders has been among the top recommendations in the 2006, 2007, 2008, 2009, 2010, and 2011 Government-Business Forum on Small Business Capital Formation hosted by the SEC[20] at the direction of Congress (the topic of M&A brokers and finders was not on the SEC's agenda for the 2012 forum). The *Final Report of the Advisory Committee on Smaller Public Companies* (2006), reached the same conclusion in Recommendation IV.P.6, page 81[21], as did the *Report and Recommendations of the Private Placement Broker-Dealer Task Force* of the Business Law Section of the American Bar Association.[22]

In light of this well-articulated need, in 2006 the AM&AA, with the support of the IBBA and its M&A Source, and 14 regional professional associations of M&A brokers, began developing and actively seeking a simplified system of "broker" registration and regulation under the Exchange Act for M&A brokers advising buyers or sellers in purchases, sales, mergers, and acquisitions of privately-owned companies. The AM&AA developed and presented proposed rules to the SEC staff in March 2007. The rulemaking proposal was expanded in March 2008 to add a proposed codification of the *Country Business, Inc.* no-action letter into an SEC rule defining circumstances when no type of broker registration would be required. On a parallel track, the AM&AA also developed and presented proposed model state rules to NASAA to develop a coordinated and complementary system of simplified state registration and regulation in March 2007. The model rule proposal was expanded in March 2008 to create a model state-level codification of the *Country Business, Inc.* no-action letter.

Neither the SEC nor NASAA have taken any action to address these small business issues, though significant time and attention has been paid by each of them in their consid-

[20] Available on the SEC's website at http://sec.gov/info/smallbus/sbforum.shtml.

[21] Available on the SEC's website at http://sec.gov/info/smallbus/acspc/acspc-finalreport.pdf.

[22] The ABA PPB Task Force Report is available on the SEC's website at http://sec.gov/info/smallbus/2009gbforum/-abareport062005.pdf.

eration and there have been discussions between them at their annual "Section 19d" meetings. With more than six years passing without rulemaking, and the prospect for rulemaking any time soon unlikely, the AM&AA and IBBA have turned to Congress to address and mandate the SEC's consideration these small business issues.

The Small Business Brokerage Act (H.R. 2274)

The Small Business Brokerage Act (H.R. 2274) would amend the Exchange Act by adding a new subsection to Section 15, which governs broker-dealer registration. The amendment would reduce the regulatory costs incurred by sellers and buyers of small and mid-sized privately held companies for professional business brokerage services, while enhancing their protection through well defined, appropriately scaled, and cost effective federal securities regulation. It would direct the SEC to create a simplified system of registration through a public notice filing, publicly available on the SEC's website, and would require appropriate client disclosures, pertaining to M&A brokers and their associates. The bill would also direct the SEC to tailor its rules governing M&A brokers in light of the limited scope of their activities, the nature of privately negotiated M&A transactions, and the active involvement of buyers and sellers in those transactions.

Important investor protections would be preserved. Federal law would continue to control the capital, custody, margin, financial responsibility, recordkeeping, bonding, and financial or operational reporting requirements applicable to M&A brokers, tailored by the SEC to their circumstances. Statutory disqualifications would continue to apply. The SEC, in coordination with state securities regulators, would establish the content of the notice registration and disclosures, and could establish uniform and consistent standards of training, experience, competence, and qualifications for the associates of M&A brokers, presently prescribed by FINRA. M&A brokers would be exempt from membership in and regulation by FINRA. Existing state securities laws would continue to apply.

Being SEC-registered, an M&A broker could exchange client referrals with fully-registered broker-dealers, thus better assuring that small business clients could be cost-effectively served by appropriately regulated brokers. M&A brokers could not have custody of the funds or securities exchanged by the parties. An M&A broker could not be involved in capital-raising beyond the context of M&A transactions and could not be engaged by an issuer in a public offering of its securities.

Conclusion

Regulatory reengineering is urgently needed to lower regulatory costs incurred by small and mid-sized privately held businesses and the M&A professionals who serve them. Reengineering is needed to make federal securities relevant and effective in this business context. In this context the perception of public perception under the current "one-size fits all" system of broker-dealer regulation is illusory, as there are thousands of small firms engaged in M&A brokerage activities who are not registered because the current body of regulation simply does not address the professional services they provide to small and mid-sized businesses.

The Small Business Brokerage Act would provide a simple, but practical and workable, regulatory architecture for "multitudes" of M&A brokers and small business owners

who, today, regularly conduct critical commercial transactions that are extremely valuable to our economy, jobs and commerce. The simplified public notice-filing system would better assure that information about M&A brokers is readily publicly available. The Act adds public protections that do not exist today. Mandated disclosures, including conflicts of interest, would better inform sellers and buyers before they engage the services of an M&A broker. The Act and relevant SEC rules will clarify the application of federal securities law in this context, and so can reasonably be expected to improve compliance. The Act would achieve these objectives with comparatively minimal set up and administrative costs. This will ultimately free-up SEC and FINRA resources to more effectively accomplish their statutory mandate of protecting our public markets and passive investors.

A high Congressional priority has been the critical need to preserve and create jobs to fuel our nation's economic recovery. Today, jobs preservation and growth would be significantly boosted by assuring that retiring baby boomers, aspiring entrepreneurs, and growing companies can be professionally and cost-effectively advised by appropriately regulated M&A brokers. An estimated $10 trillion of wealth is passing between generations. Reducing the cost of professional business brokerage services to privately-owned companies would facilitate an efficient, free-flow of capital between small and mid-sized business sellers and buyers. Thank you for your consideration and I urge you to support H.R. 2274 in order to address this critically important small business issue.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

THE CHAIRMAN

January 11, 2012

The Honorable Bill Posey
U.S. House of Representatives
120 Cannon House Office Building
Washington, DC 20515

Dear Representative Posey:

Thank you for your December 19, 2011 letter in which you request information about the status of a recommendation by the SEC's Government-Business Forum on Small Business Capital Formation ("the Forum") regarding merger and acquisition intermediaries, also known as business brokers. As you know, the Forum provides an annual gathering that focuses on the capital formation concerns of small business. The Forum provides a crucial platform for small businesses to highlight impediments to the capital raising process that may be unnecessary and develop recommendations for governmental action. As you mention in your letter, the Forum has recommended that the SEC adopt a rule providing "an exemption from federal broker-dealer registration and FINRA membership for merger and acquisition (M&A) intermediaries and business brokers involved in the purchase, sale, exchange or transfer of the ownership of privately-owned businesses, subject to the states exercising primary regulatory supervision over these activities under state securities laws."

I have directed the staff of the Division of Trading and Markets, the Division primarily responsible for administering the regulation of brokers and dealers, to analyze carefully the Forum's recommendation and to develop options the Commission may consider in revisiting the regulations that apply to M&A intermediaries who serve small businesses. I also have directed the Division's staff to revisit existing guidance about whether there is any need for certain M&A intermediaries to be registered with the SEC as brokers and to determine whether we should provide further clarity in this area. The Commission staff and I are mindful of the importance of weighing the burdens on small businesses' capital formation arising from our regulatory requirements against the benefits of those regulations.

Thank you again for your letter. Please call me at (202) 551-2100, or have your staff call Eric Spitler, Director of the Office of Legislative and Intergovernmental Affairs, at (202) 551-2010 if you have any questions or comments.

Sincerely,

Mary L. Schapiro
Chairman

Congress of the United States
Washington, DC 20515

December 19, 2011

The Honorable Mary Schapiro
Chairman
Securities and Exchange Commission
Washington, D.C. 20549

Dear Chairman Schapiro,

As Congress continues to work to see that our economy recovers, we continue to be vigilant to ensuring that regulations affecting small businesses are smart and proper. It is essential that regulation works to stimulate economic growth. It is our understanding that for five years in a row, the SEC's Government-Industry Forum on Small Business Capital Formation has highlighted the merger and acquisition broker (MAB) proposal as one of its top recommendations to help small businesses – we urge you to consider this proposal.

As you know, the MAB proposal would address securities regulation of business brokers and merger and acquisition advisors who are in the business of facilitating the purchase and sale of privately held companies. This proposal would significantly reduce their federal regulation compliance costs, which I am informed can initially exceed $150,000 and cost $75,000 per year after that.

According to the final report from the 2010 forum, the MAB proposal would eliminate unnecessary regulation as these private sales are already regulated by state laws. Specifically, the MAB proposal states:

> "The Commission should, by rule, adopt an exemption from federal broker-dealer registration and FINRA membership for merger and acquisition (M&A) intermediaries and business brokers involved in the purchase, sale, exchange or transfer of the ownership of privately-owned businesses, subject to the states exercising primary regulatory supervision over these activities
> under state securities laws."

We are aware that the SEC hosted its 2011 Government-Industry Forum on Small Business Capital Formation on November 17, 2011, and the MAB proposal was once again on the agenda. We write to inquire about the status of this proposal at your agency. What action to date has the SEC taken to implement these recommended changes? If the SEC has not acted on this yet, please tell us the timeframe the SEC is operating under to implement these regulations. If impediments exist that preclude your agency from publishing such a rule, please advise us as to the barriers precluding the regulation from advancing.

Sincerely,

Bill Posey (FL-15)
Member of Congress

Brian Higgins (NY-27)
Member of Congress

Allen B. West (FL-22)
Member of Congress

Doug Lamborn (CO-05)
Member of Congress

Joe Walsh (IL-08)
Member of Congress

Joseph J. Heck (NV-03)
Member of Congress

Bill Huizenga (MI-02)
Member of Congress

Randy Hultgren (IL-14)
Member of Congress

Hansen, Shane

Subject: FW: Shapiro Question for Record Response

From: Behnam, Rostin (Agriculture) [mailto:Rostin_Behnam@ag.senate.gov]
Sent: Thursday, August 16, 2012 11:23 AM
To: Hansen, Shane
Subject: Shapiro Question for Record Response

Shane—

As promised, Chairwoman Shapiro's response to the question for the record from the December, 2011 hearing.

2) Prior to the financial crisis, the Securities and Exchange Commission made significant progress in adopting a rule that would have created a limited federal exemption for business brokers who act in limited roles as both intermediaries and advisors during the purchase and sale of existing small businesses. In 2006, the Commission issued a no-action letter granting enforcement relief to a small business broker who acted in a limited role during a business sale. Small business development, which includes the purchase and sale of existing businesses, is paramount to developing a strong economic base. Has the SEC considered taking additional steps to codify this limited small business broker exemption?

RESPONSE: The staff of the Division of Trading and Markets, which is primarily responsible for administering the regulation of brokers and dealers, is analyzing the SEC's rules and regulations that apply to business brokers. The Division staff is developing options that it could recommend that the Commission consider to revise those regulations in light of the role that business brokers play in the purchase, sale, exchange or transfer of the ownership of privately owned businesses. The Division staff is also revisiting existing guidance about whether certain business brokers must be registered with the SEC as brokers in order to determine whether the Commission or the staff should provide further guidance in this area. We are mindful of the importance of considering both the burdens on small businesses' capital formation arising from our regulatory requirements and the benefits of those requirements to investors and other market participants.

Take care and keep in touch,

Russ

Counsel | U.S. Senate Committee on Agriculture, Nutrition, and Forestry
Office of U.S. Senator Debbie Stabenow, D-MI
328-A Russell Senate Office Building, Washington DC 20510
rostin_behnam@ag.senate.gov | P - 202-224-2035 | F - 202-228-2125

SHANE B. HANSEN
BIOGRAPHICAL SUMMARY

SHANE B. HANSEN is a partner and co-chairs the Broker-Dealer and Investment Adviser Practice Group in the law firm of Warner Norcross & Judd LLP. His law practice spans more than 30 years and concentrates in the area of financial services regulation, primarily including federal and state securities and banking laws and related rules. He advises broker-dealers, M&A and business brokers, investment advisers, banks, and private fund advisers about a wide range of business, corporate, contract, compliance, and regulatory topics. He has substantial experience involving formations, mergers, acquisitions, and sales of financial services firms. He was recognized in *The Best Lawyers in America*®, *Corporate Law and Securities Regulation, 2007 through 2012 editions* and named a "super lawyer" in the 2006, 2007, and 2009 through 2012 editions of *Michigan Super Lawyers*®.

Mr. Hansen chairs the Committee on State Regulation of Securities in the Business Law Section of the American Bar Association (2011-present). The committee is comprised of more than 600 lawyers, paralegals, state regulators, and law professors from around the country. He also co-chairs its Subcommittee of Liaisons to Securities Administrators in the U.S. and Canada (2007-present), producing an annual report on state securities law developments. He is an active member of the ABA's Committee on Federal Securities Regulation and the State Bar of Michigan's Securities and Financial Institutions Committees. Other professional and associate memberships include the Compliance and Legal Society of the Securities Industry and Financial Markets Association (SIFMA), the Financial Services Institute (FSI), the Investment Adviser Association (IAA), the Financial Planning Association (FPA), and the National Society of Compliance Professionals (NSCP). Mr. Hansen graduated with honors from the University of Michigan Law School in 1982. He graduated with high honors from Albion College in 1979.

Warner Norcross & Judd LLP is a full service law firm with over 220 attorneys practicing from offices in Grand Rapids, Southfield, Holland, Midland, Muskegon, Lansing, and Sterling Heights, Michigan. The firm's Broker-Dealer and Investment Adviser Practice Group is an interdisciplinary group of attorneys with experience dealing in the full range of matters and issues that are important to broker-dealers, investment advisers, financial planners, merger and acquisition intermediaries, finders, and others who may be subject to federal and state securities laws, rules and regulations, as well as FINRA rules, regulation, and enforcement. Client matters include corporate, contracts, formation and registration, compliance, mergers and acquisitions, as well as responding to examination deficiencies, enforcement, customer arbitration, and litigation. Other client matters include human resources, labor, and benefits, trusts and estates, and tax. The firm represents a wide range of clients from large to small, with various business models, and located in various parts of the country.

More information about Shane and the law firm can be found on the Internet at: www.wnj.com. He can be reached at 616-752-2145 or shansen@wnj.com.

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