

Transcript:

Registered Finders' AML-CIP Requirements

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KATHY: In recent years, the SEC has increased its scrutiny of unregistered finders. As a result, a growing number of finders are registering as broker-dealers because of the limitations on receiving transaction-based compensation if they're not registered. And with registration, comes compliance responsibilities.

BEN: That's right. And bear in mind that these compliance obligations are considerable, especially in view of the fact that registered finders typically perform very limited brokerage functions: often, just soliciting prospective investors, and possibly helping to structure deals. Registered finders typically operate under a minimum net capital requirement of \$5,000. They also tend to have limited staff and resources, so the scope of their compliance responsibilities can be a real concern.

KATHY: One such concern we've heard from finder firms is whether they are really required to have an AML - Customer Identification Program. CIP is the type of requirement that a finder may overlook, not seeing it as relevant or capable of practical implementation. Nonetheless, we know that FINRA has issued cautionary letters to firms without such a program. And FINRA has told such firms that they should verify the identities of both issuers and institutional investors.

BEN: In addition to verifying customer identity, firms must review the names of the customers against government terrorist lists and maintain written CIP compliance and supervisory procedures. The program can be costly and time consuming, and is especially burdensome to small broker-dealers. And we believe there is a real issue as to whether the underlying statutory requirements were ever meant to apply to finder-only firms.

KATHY: That's right. A broker-dealer's CIP requirement applies only to a "customer," which is a person that opens a "new account." And an "account" is a "formal" relationship with a broker-dealer established to effect securities transactions. But finder firms don't generally have "customers" that open "accounts" to "effect securities transactions." Registered finders simply introduce institutional investors to funds or companies looking for

capital, and the investors and the issuers then negotiate among themselves. If a deal closes, the finder gets paid.

BEN: Now, that said, the SEC does view the concept of “effecting securities transactions” very broadly. And, SIFMA’s recommendations on CIP Practices note that the definition of “account” contemplates various types of “non-account” relationships. And while SIFMA recognizes that a brokerage firm may sell private placements without opening an account, it nevertheless concludes that the firm must verify the customer’s identity.

KATHY: Yet, in contrast to traditional brokerage firms, a finder firm typically doesn’t get involved in the execution or processing of securities transactions. A finder firm may introduce an issuer to a number of prospective investors. The finder may not even learn that one of those prospects has invested until the deal closes. Should it conduct CIP on every potential investor?

BEN: Well that’s a legitimate question. Even when the broker has some role in structuring the transaction or communicating payment instructions, the ultimate transfer of funds and securities typically involves a bank, which has its own CIP responsibility. So, a second layer of CIP by the finder firm seems superfluous.

KATHY: Arguably, the CIP requirements weren’t intended to apply to brokers that don’t get involved in the transfer of customer funds or securities – and that’s the heart of money laundering activity.

BEN: In fact, a private placement firm operating under the \$5,000 minimum net capital requirement is prohibited from receiving or holding customer funds or securities or carrying customer accounts. And, of course, private placements generally are not associated with money laundering since they’re not very liquid investments.

KATHY: Under the circumstances, we believe that there’s a legitimate interpretive issue as to whether the Customer Identification requirements were meant to apply to finder only firms. In our view, the issue may be important enough for some firms to think about requesting interpretive guidance or no-action relief from the SEC staff.