

PUBLICATION

SEC Focus on Unregistered Broker-Dealers – Implications for Regulated Entities

May 13, 2013

In March, the Securities and Exchange Commission (SEC) announced administrative sanctions against Ranieri Partners LLC, which controls two private equity funds, as well as a former executive of Ranieri and a third-party "finder" for Ranieri in connection with the "finder" acting as a broker-dealer without being registered as such with the SEC. Last month, David Blass, chief counsel for the SEC in the Division of Trading and Markets, announced in a speech the SEC's focus on pursuing enforcement against persons related to private funds engaged in broker-dealer activities without being registered as broker-dealers.

For registered firms who are required to incur significant administrative costs to attain and maintain their registration, the SEC's actions and statements with respect to unregistered broker-dealers may appear to be a positive development at first glance. However, it is clear from both the administrative action and the speech by Mr. Blass that registered firms may also be at risk from the SEC's new focus.

In the administrative order issued in March, the SEC determined that William M. Stephens operated as an unregistered broker in violation of federal securities laws by actively soliciting investors on behalf of private funds and receiving transaction-based compensation. However, the SEC did not limit the administrative sanctions to Mr. Stephens, but also imposed administrative sanctions on the sponsor of the private funds and an executive employed by the sponsor on the basis that they "caused" the violations by providing information to Mr. Stephens that allowed him to engage in brokerage activities without registration.

In his speech, Mr. Blass noted that since "private funds have become an increasingly large part of the financial marketplace in the last couple of years," the SEC intends to focus upon the activities of such funds. In the course of examinations of registered investment advisers, advisers who advise private funds should anticipate the SEC's examiners focusing upon whether any investors in the private funds have been solicited by unregistered broker-dealers. In the event the SEC determines such activity has taken place, an investment adviser could potentially be liable if the SEC concludes that the investment adviser has aided and abetted the unregistered person's violations of the broker-dealer registration rules.

For registered broker-dealers, it is important to carefully analyze any investment banking engagements to determine whether unregistered persons may be receiving improper compensation in connection with an engagement, either directly or indirectly from the issuer, investors, or other parties. As evidenced by the SEC's administrative action against Ranieri Partners, LLC and its executive, there is a distinct likelihood that the SEC would impose penalties on any third parties who facilitated the violation of the registration requirement. In addition, FINRA rules prohibit the sharing of commissions with unlicensed brokers, aside from certain very limited exceptions, so registered broker-dealers also face potential FINRA scrutiny if persons who are not registered as broker-dealers receive a portion of any transaction-based compensation from a securities transaction.

Occasionally it is clear that a person or entity is acting as a broker that should be registered with the SEC, such as when an unregistered person or entity actively solicits investors and is paid transaction-based compensation on a regular basis. However, in a number of cases, the circumstances are less clear, especially for parties who ostensibly provide other services in connection with a particular transaction. Therefore, in

instances where an unregistered person is involved in a securities transaction, it is important to consult with securities counsel to determine if such persons may be acting as unregistered brokers.

If you have questions about this or any other securities-related issues, please contact any of the attorneys in our broker-dealer practice group or your Baker Donelson attorney.