CHAPTER 2

Broker-Dealers Regulation

Almost all trades of securities are accomplished through the services of brokers and dealers. In the United States, there are some 5,100 broker-dealers with over 600,000 registered representatives servicing 110 million customer accounts. Most brokerage firms are small with ten or less employees. The number of daily trades of securities may run into hundreds of millions of dollars or even trillions globally. Whenever significant amount of moneys are at stake, the spectra of fraud, incompetence, and mismanagement inevitably accompany them. Statutory and regulatory measures have been enacted to lessen the degree of harm that impacts the securities industry. In the preceding chapter on investment advisers, we examined the role of persons holding themselves out as experts assisting investors concerning their options in maximizing their monetary returns. In this chapter, we will review the regulation of persons who perform the services of purchasing and trading in securities and discuss the impact of the Dodd–Frank Act and other statutes on them. Often, securities firms both perform investment services and engage in trades of the many varieties of securities, which may engender many issues including potential conflicts of interest that may arise under such circumstances.

Brokers and Dealers Defined

Brokers

A “broker” is defined under §3(a)(4)(A) of the Exchange Act as “any person engaged in the business of effecting transactions in securities for the account of others.” Investors are familiar with both standard forms of brokerage services and heavily advertised discount brokers who execute trades on behalf of investors. In most circumstances, the broker is acting as an agent for the client. A broker-dealer may act, however, in many capacities other than the ministerial act of executing trades. Thus, the broker-dealer may

- Offer margin accounts.
- Give clients stock quotes and information about particular companies.
• Provide specific research results concerning a particular company.
• Operate a call center.
• Engage in discretionary or non-discretionary portfolio management.
• Provide debit cards.
• Provide bill payment and other services in connection with clients’ accounts.

The meaning of “broker” nevertheless, may become obscure once a variety of other persons engage in services that assist the transfer of securities come into play, such as “finders,” “business brokers,” and others. The distinction becomes important because most brokers are required to register with the SEC, with an SRO, and/or state regulatory authorities. Finders may be required to register with the SEC if they provide support services to registered broker-dealers. These support services may include the following:

• Marketing of real estate investment interests.
• Acting as placement agents.
• Acting for private placements of securities.
• Effecting or facilitating securities transactions.
• Finding investors for issuers or investment banking clients for registered broker-dealers.
• Otherwise playing an important role in the act of soliciting, negotiating, or executing securities’ transactions.¹

An example of such services is the following SEC order.

Ramcapital Resources, LLC., In Re
SEC Release No. 60149 (June 19, 2009)

Ram and its principals acted as an intermediary in the PIPEs (an acronym for “private investments in public equities”) market. From 2001 through early 2005, they engaged in the business of identifying investors for PIPE offerings. Upon identifying a PIPE offering or a potential PIPE offering, Ram solicited investors—a majority of which were hedge funds—to invest in the offering. The investors then compensated Ram by paying to it a certain percentage of the gross amount invested and, in most instances, allocated to Ram a certain percentage of any warrants they received as part of their investment. Ram also engaged in structuring PIPE offerings and negotiating the terms of such offerings with investors and issuers. Because of their failure to register with the SEC, the parties were ordered to cease and desist from such activities; Ram was censured; its principals were suspended from associating with any broker-dealer for a designated time period; and significant disgorgement penalties were imposed.