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LEGAL ISSUES FOR BROKER-DEALERS IN RELATION TO PRIVATE SECONDARY MARKET TRADING

Given the rapid growth in private securities markets, broker-dealers are increasingly being provided with opportunities to facilitate private secondary transactions. “Section 4(a)(1½)” offers flexibility to broker-dealers in effecting such transactions in a manner exempt from registration under the Securities Act of 1933. At the same time, however, since Section 4(a)(1½) is not a codified exemption from registration and is effectively an amalgamation of primary private placement and secondary market principles, it can create uncertainties for broker-dealers who wish to utilize it. In this article, we examine the legal analysis underlying Section 4(a)(1½) and the various regulatory considerations that should be taken into account by broker-dealers in relation to it.

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The rise of private markets has been one of the most significant trends in capital markets in recent years.¹ With the fast growth in the private markets, market participants have increasingly been exploring different ways in which to regularly engage in secondary transactions in private securities.

While Rule 144 and Rule 144A under the Securities Act of 1933, as amended, continue to be the exemptions from registration under the Securities Act for private resale transactions that provide the most certainty and are most commonly relied on by market participants,

their various conditions, and restraints (e.g., holding periods and information requirements) can lead U.S. broker-dealers to look to different alternatives towards more flexibly facilitating trading of private securities by their customers. One such alternative is Section 4(a)(7) of the Securities Act, which was enacted by Congress in 2015, however it has not been widely adopted by market participants and has its own set of conditions that render it inflexible. Accordingly, broker-dealers looking for maximum flexibility for their customers have the option of turning to so-called “Section 4(a)(1½).” In this paper, we examine the legal analysis underlying Section 4(a)(1½) and the various regulatory considerations that should be taken into account by broker-dealers that facilitate transactions that utilize it.

I. SECURITIES ACT FRAMEWORK

Section 5 of the Securities Act generally requires that each offer and sale of a security (whether in connection

¹ Private markets assets under management totaled \$13.1 trillion as of June 30, 2023, and have grown nearly 20 percent per annum since 2018. Private markets: a Slower Era, McKinsey Global Private Markets Review 2024, McKinsey & Company available at https://www.mckinsey.com/industries/private-capital/our-insights/global-private-markets-report-2024#.

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