

SEC Proposes Exemption from Broker-Dealer Registration for Finders Assisting Small Businesses with Capital Raising

On October 7, 2020, the Securities and Exchange Commission ("SEC") proposed a new limited, conditional exemption from broker-dealer registration requirements of Section 15(a) of the Securities and Exchange Act of 1934, as amended ("Exchange Act") for "finders" who assist issuers with raising capital in private markets from accredited investors. The proposed exemption would permit natural persons to engage in certain defined and limited activities involving accredited investors without registering with the SEC as brokers. The proposed exemption seeks to assist small businesses to raise capital and to provide regulatory clarity to investors, issuers, and the finders who assist them.

There will be a 30-day comment period for the proposed exemption following publication in the Federal Register. The SEC published a series of 45 questions at the end of the proposal seeking feedback.

The Proposal Is Narrowly Focused

Similar in nature to the SEC's 2014 M&A Broker No Action Letter that provided narrow conditions under which a person could operate as an M&A Broker without registering as a broker-dealer under the Exchange Act, the SEC's proposed relief is intended to be narrowly-tailored and seeks to address the capital formation needs of certain smaller issuers while preserving appropriate investor protections. Finders would only be able to utilize the exemption if the offering satisfies seven (7) specified conditions. These conditions are detailed below.

- The issuer is not required to file reports under Section 13 or Section 15(d) of the Exchange Act.
- The issuer is seeking to conduct the securities offering in reliance on an applicable exemption from registration under the Securities Act.
- The finder does not engage in general solicitation.
- The potential investor is an "accredited investor" as defined in Rule 501 of Regulation D or the finder has a reasonable belief that the potential investor is an "accredited

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investor.”

- The finder provides services pursuant to a written agreement with the issuer that includes a description of the services provided and associated compensation.
- The finder is not an associated person of a broker-dealer.
- The finder is not subject to statutory disqualification, as that term is defined in Section 3(a)(39) of the Exchange Act, at the time of his or her participation.

The Proposal Would Create Two Tiers of “Finders.”

The proposed exemption would create two classes of exempt finders, Tier I Finders and Tier II Finders, which would be subject to conditions tailored to the scope of their respective activities. Tier I and Tier II Finders would both be permitted to accept transaction-based compensation under the terms of the proposed exemption.

A Tier I Finder would be limited to providing contact information of potential investors in connection with only a single capital raising transaction by a single issuer in a 12 month period. A Tier I Finder could not have any contact with a potential investor about the issuer.

The activities that a Tier I Finder would be permitted to undertake closely track the narrowly tailored SEC No Action Position in the *Paul Anka Letter*. In the *Paul Anka Letter*, the SEC stated that it would not recommend enforcement action against an individual who, without registering with the SEC as a broker-dealer: (1) entered into an agreement with an issuer to provide to the issuer a list of names and telephone numbers of potential investors he reasonably believed to be accredited investors and with whom he had a pre-existing business or personal relationship, (2) had no further contact with potential investors concerning the issuer, and (3) received a finder’s fee for doing so. However, the *Paul Anka Letter* only permitted the individual to act as a finder on a single occasion. The SEC’s new proposal would allow a Tier 1 Finder to act as a finder more than once, as frequently as once every 12 months and a day.

A Tier II Finder would be able to expand his or her activities, but would have a higher burden of documentation. A Tier II Finder would be permitted to engage in solicitation-related activities on behalf of an issuer, that are limited to: (i) identifying, screening, and contacting potential investors; (ii) distributing issuer offering materials to investors; (iii) discussing issuer information included in any offering materials, provided that the Tier II Finder does not provide advice as to the valuation or advisability of the investment; and (iv) arranging or participating in meetings with the issuer and investor.

The SEC stated that the identification of these activities is not an exhaustive listing of activities that may constitute solicitation. Rather, these are the limited solicitation-related activities permissible under the proposed exemption.

Tier II Finder wishing to rely on the proposed exemption would need to satisfy certain disclosure requirements and other conditions in order to rely upon the proposed exemption.

Tier II Finders would need to provide a potential investor, prior to or at the time of the

solicitation, disclosures that include the following items:

- (1) the name of the Tier II Finder;
- (2) the name of the issuer;
- (3) the description of the relationship between the Tier II Finder and the issuer, including any affiliation;
- (4) a statement that the Tier II Finder will be compensated for his or her solicitation activities by the issuer and a description of the terms of such compensation arrangement;
- (5) any material conflicts of interest resulting from the arrangement or relationship between the Tier II Finder and the issuer; and
- (6) an affirmative statement that the Tier II Finder is acting as an agent of the issuer, is not acting as an associated person of a broker-dealer, and is not undertaking a role to act in the investor's best interest.

The SEC proposes to allow a Tier II Finder to provide such disclosure orally, provided that the oral disclosure is supplemented by written disclosure and satisfies all of the disclosure requirements listed above no later than the time of any related investment in the issuer's securities.

The Tier II Finder must obtain from the investor, prior to or at the time of any investment in the issuer's securities, a dated written acknowledgment of receipt of the Tier II Finder's required disclosures. This acknowledgement may be evidenced by written or electronic means.

Prohibited Activities of Finders

There are certain activities that a finder could not do under the proposed exemption. Importantly, the proposed exemption would be limited to primary offerings by an issuer. Transaction based compensation on secondary sales would not be permitted.

Additionally, a finder could not (i) be involved in structuring the transaction or negotiating the terms of the offering; (ii) handle customer funds or securities or bind the issuer or investor; (iii) participate in the preparation of any sales materials; (iv) perform any independent analysis of the sale; (v) engage in any "due diligence" activities; (vi) assist or provide financing for such purchases; or (vii) provide advice as to the valuation or financial advisability of the investment.

Finally, a finder could not rely on this proposed exemption to engage in broker activity beyond the scope of the proposed exemption. Among other things, a finder could not rely on this proposed exemption to facilitate a registered offering, a resale of securities, or the sale of securities to investors that are not accredited investors or that the finder does not have a reasonable belief are accredited investors.

Limitations on Proposed Exemptions

If a finder fails to comply with any of the relevant conditions (for example, the finder

engages in general solicitation of potential investors), the finder could not rely on the proposed exemption. The inability to rely on the proposed exemption means that the finder may need to consider whether it is required to register with the SEC as a broker under Section 15(a) of the Exchange Act.

The proposed exemption would not affect a finder's obligation to continue to comply with all other applicable laws, including the antifraud provisions of the Securities Act and the Exchange Act, such as the obligations under Section 10(b) and Rule 10b-5 under the Exchange Act, and state law. In addition, this exemption is not intended to affect the rights of the SEC or any other party to enforce compliance with other applicable law, or the available remedies for violations of the law.

Finally, a finder may need to consider whether he or she is acting as another regulated entity, such as an investment adviser or a municipal advisor. For example, an exemption from the obligation to register as a broker-dealer does not insulate a person from the registration requirements of the Investment Advisers Act of 1940, as amended, if such person is acting as an investment adviser.

Next Steps

The SEC has provided a helpful [chart](#) that compares the permitted activities of Tier I Finders, Tier II Finders and registered broker-dealers.

The SEC has requested comment on the proposed exemption. Specifically, the SEC provided 45 questions at the end of the proposed exemption for comment. The comment period will run 30 days after the proposed exemption appears in the Federal Register.