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SEC Proposes Conditional “Finder” Exemptions to Broker-Dealer Registration Requirements

In an effort to assist small businesses with their capital raising needs, the SEC recently proposed an exemptive order (available [here](#)) which, if issued, would offer limited conditional exemptions from broker-dealer registration for natural persons who assist non-Exchange Act reporting issuers in raising capital from accredited investors (“Finders”). To assist non-reporting issuers in understanding the permissible activities, requirements and limitations set out in the proposed exemptive order, the SEC also posted two education tools on its website (available [here](#)).

Background

For years, the regulatory status of persons who play discrete roles in bridging the funding gap between issuers and investors has been unclear. The question has been at what point does someone with a “rolodex” of contacts who is willing, for a fee, to assist issuers in finding investors (hence the term “Finders”) cross the line and trigger broker-dealer registration. Specifically, at what point is someone “engaged in the business of effecting transactions in securities for the account of others,” which invariably turns on the relevant facts and circumstances. The issue has been particularly relevant for smaller businesses because, as the SEC noted in its proposing release, the uncertainty as to where that line is drawn has meant that some engage in activities that should be regulated, while others have declined to play a useful role because of the uncertainty associated with capital raising without broker-dealer registration. In the meantime, smaller private businesses, in particular, have faced significant challenges in their quest to identify and contact investors who can provide much needed capital to enable these companies to fund growth and achieve scale.

In 2005, an ABA Task Force recommended a simplified system to allow small issuers to solicit investors with a reduced level of regulation. The Department of the Treasury and various SEC advisory committees also recommended a separate regime for Finders. In 2014, the SEC staff issued a no-action letter for persons facilitating transactions in securities in connection with the transfer of ownership of controlling interests in privately held operating companies (the “M&A Broker Letter”).

In keeping with one of its missions, namely facilitating capital formation in the United States, the SEC now has proposed conditional exemptions for Finders.

Proposed Exemptive Order

The proposal creates two classes of Finders exempt from broker-dealer registration – Tier I Finders and Tier II Finders – that would be distinguished by the types of activities they may engage in and the disclosure they would be required to provide, and sets forth a number of conditions that would need to be met by both classes of Finders.

Tier I Finders. A Tier I Finder's activities would be limited to providing contact information (such as name, telephone number, e-mail address, and social media information) of potential investors in connection with only one capital raising transaction by a single issuer within a 12-month period. The Tier I Finder may not have any contact with potential investors about the issuer.

Tier II Finders. A Tier II Finder would be permitted to engage in the same activities as a Tier I Finder as well as these additional limited solicitation-related activities:

- identifying, screening and contacting potential investors;
- distributing issuer offering materials to investors;
- discussing issuer information included in any offering materials, provided that the Finder does not provide any advice as to the valuation or advisability of the investment; and
- arranging or participating in meetings with the issuer and investor.

Tier II Finders would need to provide certain disclosures to potential investors, including:

- the name of the Tier II Finder and the name of the issuer;
- a description of the relationship between the Tier II Finder and the issuer;
- a statement regarding the compensation arrangements between the Tier II Finder and the issuer;
- disclosure of any material conflicts of interest resulting from the relationship between the Tier II Finder and the issuer; and
- 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.

These disclosures would need to be made at or prior to any solicitation in order to give investors adequate time to consider the information as part of making an informed investment decision. The disclosures

could be provided orally, so long as they are supplemented by written disclosure meeting the same requirements, which would need to be provided to the potential investor no later than the time of any investment. A Tier II Finder would also be required to obtain written acknowledgement of receipt of these disclosures by the potential investor, dated at or prior to the time of investment.

Conditions Applicable to Both Tier I and Tier II Finders. Both Tier I and Tier II Finders would be eligible for an exemption from broker-dealer registration only when all of the following conditions are also met:

- 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 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” or the Finder has a reasonable belief that the potential investor is an “accredited 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; and
- the Finder is not subject to statutory disqualification, as defined in Section 3(a)(39) of the Exchange Act, at the time of his or her participation.

In addition, Tier I and Tier II Finders would not be able to:

- be involved in structuring the transaction or negotiating the terms of the offering;
- handle customer funds or securities or bind the issuer or investor;
- participate in the preparation of any sales materials;
- perform any independent analysis of the sale;
- engage in any due diligence activities;
- assist or provide financing; or
- provide advice as to the valuation or financial advisability of the investment.

Tier I and Tier II Finders that comply with all the applicable conditions would be permitted to receive transaction-based compensation for the limited services they are permitted to engage in under the applicable exemption without being required to register as broker-dealers.

The proposal contemplates that these conditional exemptions for Finders would only apply in the case of primary offerings by issuers, although the SEC has requested comment on whether the relief should be extended to intermediation of secondary trades.

The SEC did note that meeting the proposed conditional exemptions from broker-dealer registration described above would not insulate persons from other regulations (*i.e.*, from the need to register under the Investment Advisers Act, if acting as an investment adviser). Moreover, the Finder would continue to be subject to the antifraud provisions of the federal securities laws. The SEC also noted that the proposed exemptive order is limited to the regulatory status of individuals who identify and solicit potential investors for an issuer as described above, and does not address the M&A Broker Letter (available [here](#)) or the associated recommendations to codify the Staff position in the M&A Broker Letter.

The proposed exemption would provide a non-exclusive safe harbor. If Finders fail to comply with the relevant conditions, they would be unable to rely on the proposed exemption, meaning they would need to consider, based on the relevant facts and circumstances as they would today, whether their activities trigger broker-dealer registration.

Comments. Market participants have 30 days following the publication of the proposed amendments in the *Federal Register* to submit comments.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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