

Practice Update

# SEC Proposes Exemption from Registration for Certain Finders

October 15, 2020

By [Paul J. Foley](#), [John M. Faust](#), and [Kiki M. Scarff](#)

On October 7, 2020, the Securities and Exchange Commission (SEC) proposed an [exemptive order](#) which would permit “finders” (*i.e.*, natural persons engaged by issuers) to solicit accredited investors in connection with private securities offerings and receive transaction-based compensation for doing so, without first having to register as brokers under the Securities Exchange Act of 1934 (the “Exchange Act”).<sup>[1]</sup>

The bedrock of the American entrepreneurial economy has long been small businesses and startup ventures, fostered in large part by the opportunities available to such startups to raise capital. One of the ways small businesses often seek to raise capital is through private securities offerings made in reliance on exemptions from registration under the Securities Act of 1933, as amended (Securities Act). However, capital raises can prove difficult when businesses and business owners lack, or are located in areas that lack, robust capital raising networks. In this regard, intermediaries with access to such networks can be instrumental in bridging the gap between small businesses that need capital and investors who are interested in supporting emerging enterprises. Historically, the patchwork of rules and regulations and inconsistency of enforcement by regulatory

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authorities has created uncertainty for such intermediaries who are not registered as brokers.

The SEC has not previously recognized a “finders” exemption or exception or broadly addressed whether and under what circumstances a person may “find” or solicit potential investors on behalf of an issuer without being required to register as a broker[2]. Instead, issuers and market participants have often looked to narrowly tailored “no-action”[3] letters for guidance on how to distinguish between “finder” and “broker” activities.

The SEC’s proposal, if adopted, will set forth clear guidance on this issue, expressly permitting natural persons to engage in certain solicitation of accredited investors, and receive transaction-based compensation for the same, without first having to register as brokers. Specifically, the proposal would create two classes of finders: Tier I Finders and Tier II Finders, with each being subject to conditions tailored to the scope of the respective activities permitted for such finders.

### Tier I Finders

Under the proposed exemption, a Tier I Finder would:

- (i) be limited to providing contact information of potential investors in connection with only a single capital raising transaction by a single issuer in 12-month period; but
- (ii) be unable to have any contact with potential investors about the issuer.

The activities of Tier I Finders would be restricted as described so as to prevent the participation in continuous or multiple sales of securities by persons that are not subject to broker registration or the heightened requirements applicable to Tier II Finders.

## Tier II Finders

A Tier II Finder may solicit<sup>[4]</sup> investors on behalf of an issuer but is limited to:

- (i) identifying, screening, and contacting potential investors;
- (ii) distributing the issuer's offering materials;
- (iii) discussing issuer information included in any offering materials (but without advising on valuation or advisability of the investment); and
- (iv) arranging or participating in meetings with the issuer and investor.

Given the unrestricted number of capital raises and issuers with respect to which a Tier II Finder would be able to act as a solicitor, a Tier II Finder would also be required to provide disclosures to investors describing the finder's role and compensation prior to or at the time of the solicitation and obtain a dated written acknowledgement of receipt of the required disclosures from each investor.<sup>[5]</sup> The disclosures must include:

- (i) the name of the Tier II Finder;
- (ii) the name of the issuer;
- (iii) the description of the relationship between the Tier II Finder and the issuer, including any affiliation;
- (iv) 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;
- (v) any material conflicts of interest resulting from the arrangement or relationship between the Tier II Finder and the issuer; and

(vi) 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.

### Additional Requirements for Both Tier I and Tier II Finders

In addition, the proposed exemption for Tier I and Tier II Finders would be available only where:

(i) the issuer is not required to file reports under Section 13 or Section 15(d) of the Exchange Act;

(ii) the issuer is seeking to conduct the securities offering in reliance on an applicable exemption from registration under the Securities Act<sup>[6]</sup>;

(iii) the Finder does not engage in general solicitation;

(iv) the potential investor is an "accredited investor" as defined in Rule 501 of Regulation D<sup>[7]</sup> or the Finder has a reasonable belief that the potential investor is an "accredited investor";

(v) the Finder provides services pursuant to a written agreement with the issuer that includes a description of the services provided and associated compensation;

(vi) the Finder is not an associated person of a broker-dealer; and

(vii) 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.

Finders complying with the conditions and requirements set forth in the exemptive order would be permitted to receive transaction-based compensation for the limited services he or she

provides to issuers without being required to register as brokers pursuant to Section 15(a) of the Exchange Act.

The SEC has provided a helpful chart ([available here](#) and reproduced below) summarizing the permissible activities under the exemptive order with respect to both Tier I and Tier II Finders and comparing these activities to those of registered broker-dealers.

## Conclusion

Currently, the exemption is in proposed form and is limited to the regulatory status of individuals who may identify and solicit potential investors for issuers of securities in the private markets.<sup>[8]</sup> There is a 30-day public comment period that expires on November 12, 2020 during which the SEC is soliciting comments on all aspects of the proposed exemption, and in particular comments on the forty-five questions the SEC set forth in the [proposal](#), as well as the costs and benefits of the proposed exemption. After the comment period expires, the SEC will determine what, if any, changes to the proposal should be made. We believe the proposed exemption, if adopted in similar form, would help clear up industry uncertainty surrounding finders and the activities that do not require registration as a broker under Section 15(a) of the Exchange Act while expanding capital raising opportunities in the private markets, particularly for small to mid-sized issuers and/or advisers to private funds.

We welcome the opportunity to hear your views and address any questions you may have regarding the proposed exemption and offer our assistance in preparing or reviewing comment letters to be submitted to the SEC during the comment period.

### **Finders Proposed Exemptive Order: Overview Chart of Tier I Finders, Tier II Finders and Registered Brokers**

The below chart<sup>1</sup> provides a summary overview of some of the permissible activities, requirements, and limitations outlined in the [proposed exemptive order](#) granting a conditional exemption from broker registration for finders.<sup>2</sup> The proposed exemptive order has not been finalized and remains subject to change. Finders may not rely on the proposed exempt activities, requirements, and limitations outlined below until such time they are made part of a final

operative exemptive order, if any, issued by the Commission.

		Proposed Finder Safe Harbors		Registered <sup>2</sup> Brokers
		Tier 1 Finders	Tier 2 Finders	
WHO	Natural person	✓	✓	✓
	Entities (including crowdfunding platforms)			✓
	Associated person of a broker-dealer			✓
\$	Transaction-based compensation	✓	✓	✓
INVESTORS	Accredited investors	✓	✓	✓
	Non-accredited investors			✓
ISSUER	Non-reporting (private) company	✓	✓	✓
	Reporting (public) company			✓
OFFERING	Primary exempt offerings	✓	✓	✓
	Secondary sales			✓
	Registered offerings (e.g., IPOs, follow-on offerings)			✓
PERMITTED ACTIVITIES	Provide investor contact information to issuer	✓	✓	✓
	Identify, screen, and contact potential investors		✓	✓
	Distribute issuer offering materials to investors		✓	✓
	Discuss issuer information included in offering materials		✓	✓
	Arrange or participate in meetings with the issuer and investor		✓	✓
	Structure the transaction or negotiate the terms of the offering			✓
	Engage in general solicitation			✓
	Handle customer funds or securities			✓
	Power to bind the issuer or the investor			✓
	Participate in the preparation of sales materials			✓
	Perform independent analysis of the sale			✓
	Engage in due diligence activities			✓
	Assist or provide financing for investment purchases			✓
	Provide advice as to the valuation or financial advisability of the investment			✓
	May participate in more than one capital raising transaction within a 12 month period		✓	✓
OTHER TERMS OF EXEMPTION	Anti-fraud protections apply	✓	✓	✓
	Written agreement with issuer required	✓	✓	*
	Written disclosure to investors required		✓	✓**
	No statutory disqualification	✓	✓	✓

- \* Depending on the activities a registered broker engages in, it may be required to enter into a written agreement with an issuer.
- \*\* While the proposed exemptive order prescribes clear disclosure criteria required of Tier II Finders, whether and the extent to which a broker-dealer is required to provide disclosures is generally based on the nature of the transaction and the rules and provisions of the Exchange Act that apply to the specific transaction.

1 This chart was created by the Office of the Advocate for Small Business Capital Formation and highlights several of the proposed terms of the conditional exemption from broker registration. It is not a rule, regulation, or statement of the Securities and Exchange Commission ("Commission"). The Commission has neither approved nor disapproved its content. This chart, like all staff guidance, has no legal force or effect; it does not alter or amend applicable law, and it creates no new or additional obligations for any person. We encourage you to look at the proposed exemptive order for more details and to share your feedback!

2 As described in the proposed exemptive order, the Commission has not broadly addressed the other types of specific activities that might implicate the Commission's regulatory regime for brokers. Activities that go beyond the scope of the proposed safe harbors outlined herein (and any that may be adopted) and ultimately whether a person is a broker within the meaning of Section 3(a)(4) turns on the facts and circumstances of the matter.

3 See 15 U.S. Code § 78o and applicable provisions of the federal securities laws and related rules and regulations. Different types of broker-dealers may engage in different types of activities. For purposes of this chart, we are assuming that a registered broker-dealer satisfies all applicable requirements and has received all necessary approvals to engage in the identified activities. There are a variety of legal requirements, including Commission and FINRA rules, that apply to transactions involving registered broker-dealers, not all of which are highlighted in this comparative finders chart. For additional information on registration as a broker-dealer, see the Division of Trading and Markets' [Guide to Broker-Dealer Registration](#).

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[1] The proposed exemption would provide relief pursuant to Sections 15(a)(2) and 36(a)(1) of the Exchange Act to permit a natural person to engage in certain solicitation activities on behalf of an issuer (each, a “Finder”), providing a non-exclusive safe harbor from broker registration.

[2] Section 3(a)(4) of the Exchange Act defines a “broker” as “any person engaged in the business of effecting transactions in securities for the account of others” and a “dealer” as “any person engaged in the business of effecting transactions in securities for the account of others.” Further, Section 15(a)(1) of the Exchange Act generally makes it unlawful for any broker-dealer to “effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security” unless the broker-dealer is registered in accordance with the federal securities laws. Individuals operating as merely “finders” in very narrow, yet unclearly defined parameters, may engage in certain activities without being required to register as brokers under Section 15(a).

[3] In connection with private placements, market participants have largely looked to the “Paul Anka” no-action letter. *See Paul Anka*, SEC Staff No-Action Letter (July 24, 1991) (“*Paul Anka* Letter”).

[4] Solicitation is generally any affirmative effort to induce or attempt to induce a securities transaction, whether it be a single securities transaction or in the course of developing an ongoing securities-business relationship. *See* 15a-6 Adopting Release at 30018. The solicitation-related activities identified in the proposed exemption are not an exhaustive list, but rather represent the limited solicitation-related activities permissible under the proposed exemption. Activities falling outside of this list may still require registration as a broker under Section 15(a) of the Exchange Act.

[5] Disclosures may be made orally, provided that any oral affirmations must be supplemented (through paper or electronic means) by written disclosures satisfying the disclosure requirements no later than at the time of any associated investment in the issuer's securities. The acknowledgement of receipt of the disclosures may be provided in written or electronic form.

[6] Failure of the issuer to comply with the conditions of an exemption from registration, through no fault of the Finder, would not, standing alone, affect the Finder's ability to rely on the proposed exemption, provided the Finder can establish that he or she did not know and, in the exercise of reasonable care, could not have known, that the issuer had failed to comply with the conditions of the exemption.

[7] This would include those individuals and entities qualifying as "accredited investors" under the SEC's recent expansion of the definition, potentially significantly broadening the pool of potential investors a Finder may engage with.

[8] The proposed exemption does not apply to M&A brokers, but calls for public comments addressing, among other items, additional guidance regarding the activities of M&A brokers requiring registration.

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This information is intended to inform firm clients and friends about legal developments, including recent decisions of various courts and administrative bodies. Nothing in this Practice Update should be construed as legal advice or a legal opinion, and readers should not act upon the information contained in this Practice Update without seeking the advice of legal counsel. Prior results do not guarantee a similar outcome.