

# **Bond Case Briefs**

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## **SEC Issues Proposed Order Exempting “Finders” from Registration Requirements.**

On October 7, 2020, the Securities and Exchange Commission announced that it had voted 3-2 in favor of a [Proposed Exemptive Order](#) granting conditional exemption from the broker registration requirements of Section 15 of the Exchange Act. The exemption would allow “finders” to engage in certain limited activities on behalf of issuers without registering as brokers. The Order seeks to provide the clarity that market participants have sought for many years. It also follows requests to address the issue from government and professional bodies including SEC advisory committees, the American Bar Association, and the U.S. Department of the Treasury. The SEC is requesting public comments on the Order.

### **Background**

Small businesses often find it challenging to connect with investors in the exempt market, particularly in regions lacking robust capital-raising networks and when they seek investment below a level that attracts venture capital or registered broker-dealers. “Finders” can help bridge this gap between businesses and investors.

However, there is insufficient clarity on when a company can properly engage a Finder or a platform that is not registered as a broker-dealer. Generally, brokers must register with the SEC and comply with comprehensive regulation because they act as intermediaries between customers and the securities markets. The Exchange Act defines a “broker” as “any person engaged in the business of effecting transactions in securities for the account of others.” Since the Act does not define what it means to be “engaged in the business” or “effecting transactions,” non broker-dealers are dissuaded from facilitating investment for early stage companies in case they are inadvertently acting as unregistered brokers. At the same time, there may be untapped capital that could help small businesses grow were it not for such regulatory uncertainty.

In the absence of definitional clarity, courts and the SEC currently look to various factors in determining whether a person is a broker. Market participants also look to SEC staff no-action letters for guidance. Unfortunately, none of these sources provide a uniform framework for participants. It is in this context, and in the hope of facilitating capital formation for small and emerging businesses, that the SEC is establishing a limited exemption from the registration requirement.

### **Proposed Order “Finder” Exemption**

The SEC proposes to permit a natural person to engage in certain defined activities on behalf of an issuer without registering as a broker. If a Finder complies with all the ‘general’ and ‘specific’ conditions below, they may assist businesses with capital formation and receive compensation for their services.

### **General Conditions**

The Finder exemption would be available where the following general conditions are met:

- the issuer is not required to file reports under Section 13 or 15(d) of the Exchange Act;
- the issuer is seeking to offer securities under an applicable exemption from registration;
- the Finder does not engage in general solicitation;
- the potential investor is an “accredited investor” under Regulation D or the Finder has a reasonable belief that the potential investor is an “accredited investor”;
- the Finder and issuer have a written agreement 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, defined in Exchange Act Section 3(a)(39)

The exemption does not permit potential Finders to engage in any of the following:

- structuring the transaction or negotiating the terms of the offering;
- handling customer funds or securities;
- binding the issuer or investor;
- participating in the preparation of any sales materials;
- performing any independent analysis of the sale;
- engaging in any “due diligence” activities;
- assisting or providing financing for purchases; or
- advising on the valuation or financial advisability of the investment.

### **Conditions Specific to Tier I and Tier II Finders**

The Proposed Order establishes two classes of Finders: Tier I and Tier II. In addition to fulfilling the general conditions above, potential Finders must also comply with requirements specific to each Tier.

A “Tier I Finder” is a Finder who *meets the general conditions and only provides contact information of potential investors for only one capital raising transaction by a single issuer within a 12-month period*. The contact information may include, among other things: name, telephone number, e-mail address, and social media information. The Tier I Finder may not have any contact with the potential investors about the issuer, nor participate in continuous or multiple sales of securities.

A “Tier II Finder” is a Finder who *meets the general conditions and engages in solicitation-related activities for an issuer*. Solicitation is “any affirmative effort to induce or attempt to induce a securities transaction.” Although solicitation is generally prohibited for unregistered persons, the activities below fall under the exemption in the Proposed Order:

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

Prior to or at the time of the solicitation, a Tier II Finder must also disclose to the potential investor:

1. the name of the Tier II Finder;
2. the name of the issuer;
3. the description of the relationship between the Finder and the issuer, including any affiliation;
4. a statement that the Tier II Finder will be compensated for their 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 between the Finder and issuer; and
  6. an affirmative statement that the Finder is acting as the issuer's agent, 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.

A Tier II Finder may make these disclosures orally if supplemented by written disclosures. Delivery of the disclosures may be evidenced by a dated written acknowledgment, obtained from the investor prior to or at the time of the investment, of receipt of the disclosures. The disclosures and acknowledgment may be in paper or electronic form.

The SEC has prepared a [chart](#) that shows the differences between the two tiers of Finders and registered broker-dealers.

Individuals hoping to act as Finders will need to remember that the exemption applies only to the defined activities and not to any related actions, such as facilitating a registered offering, reselling the securities, or selling to unaccredited investors. Furthermore, the exemption does not affect a Finder's obligation to comply with all other applicable laws, including state laws and the SEC's antifraud laws. Naturally, potential Finders will also need to ensure that they fall under the exemption and are not instead required to register with the SEC as a broker. Moreover, individuals falling under the Finder exemption may still be regulated in other ways, for example if they are an investment or municipal advisor.

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