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SEC Proposes Exemptive Order for Certain Activities of Finders.

On October 7, the U.S. Securities and Exchange Commission (Commission or SEC) released for notice and comment a proposed exemptive order (Notice)1 that would grant conditional exemption from the broker-dealer registration requirements of Section 15(a) of the Securities Exchange Act of 1934 (Exchange Act) for certain activities of "finders." If the Commission issues a final exemption, it would mark the Commission's broadest statement ever about the ability of persons not registered as broker-dealers to take transaction-based compensation for U.S.-based solicitation of investors on behalf of issuers in connection with capital-raising activities, something that historically has been considered a core activity that requires registration as a broker-dealer under the Exchange Act. In addition to potentially easing capital raising for operating company issuers, private fund advisers seeking investors in their funds may also benefit from the exemption if such advisers do not own, or are otherwise affiliated with, a registered broker-dealer.

Background

Although not officially defined in any statute or rule issued by the Commission, a finder is a person who performs some of the activities in the initial stages of a securities transaction that are normally conducted by brokers. For example, a finder may place potential buyers and sellers of securities in contact with one another and receive a fee for its services. Though 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,"2 the SEC has been historically hostile to the notion of allowing finders to conduct a business — for compensation — of making introductions without broker registration under the Exchange Act.

As recognized in the Notice, the existing law and guidance on finders is varied and inconsistent.3 Although the Commission staff has previously recognized a finders' exception, it has done so in limited circumstances that would not sustain an ongoing business. The Commission itself has not 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, or even whether such activity implicates the Commission's regulatory regime for brokers.4 Instead, market participants have had to look to guidance in SEC enforcement actions and no-action/denial of no-action letters issued by Commission staff. Although some general themes can be distilled from the no-action letters, the relief granted usually depends on the particular set of conditions and policy considerations presented and therefore may not have broader application. In addition, the no-action letters that relate to finders span over decades of market evolution, often rendering the guidance inconsistent. The settled and litigated SEC enforcement actions similarly have presented unusual facts and have had inconsistent results.

Description of the Proposed Exemption5

To provide clarity regarding the guidance on finders, the Commission in its Notice proposes to grant a conditional exemption from the broker-dealer registration requirements of Section 15(a) of the

Exchange Act to permit natural persons to engage in certain limited capital-raising activities involving accredited investors. The proposed exemption would create two classes of exempt finders, Tier I Finders and Tier II Finders, that 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.6

Conditions for Both Tier I and Tier II Finders

Finders (collectively Finders) would be subject to certain conditions. The proposed exemption for Tier I and Tier II Finders would be available only where

- 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 of 1933 (Securities Act)
- the Finder does not engage in general solicitation7
- 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 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-dealer8
- 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

Tier I and II Finders would have to comply with additional requirements as described below.

Tier I Finders

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.9 A Tier I Finder cannot have any contact with a potential investor about the issuer. Neither the Tier I Finder nor the issuer would have any disclosure requirement concerning the Finder's activities or compensation.

Tier II Finders

A Tier II Finder could directly solicit investors on behalf of multiple issuers within a given 12-month period, but the solicitation-related activities would be 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. In addition, a Tier II Finder must provide appropriate disclosures of the Tier II Finder's role and compensation, which must be made prior to or at the time of the solicitation. Further, 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 required disclosures. The Tier II Finder could not be involved in structuring the transaction or negotiating the terms of the offering, handle customer funds or securities, or bind the issuer or investor. The Tier II Finder also could not 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 for such purchases; or provide advice as to the valuation or financial advisability of the investment.

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, the proposed exemption would not affect the rights of the Commission or any other party to enforce compliance with other applicable law or the available remedies for violations of the law.

Further, regardless of whether or not a Finder complies with this exemption, it may need to consider whether it is acting as another regulated person such as an investment adviser or a municipal adviser. An exemption from the obligation to register as a broker-dealer does not insulate a person from the registration requirements of the Advisers Act if such person is acting as an investment adviser.

Some private fund advisers take the position that their internal marketing activities come within the nonexclusive safe harbor exemption in SEC Rule 3a4-1. Although SEC Rule 3a4-1 has a comparable 12-month restriction as proposed for Tier I Finders, the rule does not permit the payment of transaction-based compensation. As such, the proposed exemption may expand the ability to compensate internal fund marketing personnel.

The proposed order addresses only broker-dealer registration under Section 15(a) of the Exchange Act. It does not address separate "broker-dealer" requirements that could arise under applicable states' so-called "Blue Sky" or securities laws. All states require registration of broker-dealers subject to limited exceptions/exemptions that may not encompass Finders.

Conclusion

Following publication in the Federal Register, there will be a 30-day period for interested persons to comment on the proposal. The Commission provided a chart to further explain the parameters of its proposal, which can be found here.

The prospects for adoption of the proposal are uncertain, and it could be modified in light of comments. The November elections further cloud the prospects of the proposal; both Democratic commissioners voted against issuance of the Notice on investor protection grounds and may eventually oppose adoption of the proposal. That said, the short 30-day comment period may indicate the Commission's intention to move forward before a new administration takes the helm.

1The Notice has not yet been published in the Federal Register but is available here: https://www.sec.gov/rules/exorders/2020/34-90112.pdf.

2 Section 3(a)(4)(A) of the Exchange Act, 15 U.S.C. 78c(a)(4)(A). In accordance with this provision, Section 15(a)(1) of the Exchange Act makes it unlawful for any broker to use the mails or any other means of interstate commerce to "effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security" unless that broker is registered with the Commission. As a result, absent an available exception or exemption, a person engaged in the business of effecting transactions in securities for the account of others is generally a broker required to register under Section 15(a) of the Exchange Act. See Section 15(a) of the Exchange Act, 15 U.S.C. 78o(a).

3 See Notice at 14.

4 See Id.

5 We note the conditions of this proposed exemptive order for Finders differ from the requirements for solicitors under the Commission's proposed amendments to Rule 206(4)-3 under the Investment Advisers Act of 1940 ("Advisers Act"). See Investment Adviser Advertisements; Compensation for

Solicitations, Release No. IA-5407 (Nov. 4, 2019), 84 FR 67518 (Dec. 20, 2019) ("Cash Solicitation Rule Proposed Amendments"). These differences reflect the particular facts and circumstances surrounding the proposed permitted activities for Finders and solicitors, and the characteristics of the applicable regulatory regimes, notably that a solicitor would solicit for an investment adviser and would be subject to oversight by such investment adviser, while a Finder would solicit for an issuer and therefore would not be subject to such oversight. See Cash Solicitation Rule Proposed Amendments at 67580.

6 Because the proposed exemption would be limited to natural persons, it is not clear that a natural person could establish an entity to receive its fees.

7 This limit would seem to suggest that a Finder could not participate in a "private" offering conducted under SEC Rule 506(c), which allows the issuer to rely on the private offering exemption in Section 4(a)(2) of the Securities Act even if general solicitation is used.

8 This concept has been construed broadly in a similar context to mean that any person who is employed in a group that owns or controls a registered broker-dealer would, generally, be deemed to be an associated person of the broker-dealer, even if the person does not conduct any activities on behalf of the broker-dealer.

9 This is a comparable requirement to SEC Rule 3a4-1, a nonexclusive safe harbor exemption for certain associated persons of an issuer.

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