

# Bond Case Briefs

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## SEC Proposes Exemptive Relief From Broker Registration for Finders for Small Companies.

On October 7, 2020, the Securities and Exchange Commission (SEC) proposed to address long-standing questions regarding the applicability of the broker registration requirements to finders for small and emerging businesses.<sup>1</sup> Identifying potential investors is one of the most difficult challenges for small businesses trying to raise capital, and finders can play an important role in facilitating small-business capital formation. However, regulatory uncertainty regarding the broker registration requirements for finders has hampered the ability of small companies to make use of finders' services. Responding to the many calls for the SEC to address this lack of clarity, the SEC proposes to grant exemptive relief to permit natural persons to engage in limited activities on behalf of issuers (Finders) without registering as brokers under Section 15 of the Securities Exchange Act of 1934 (Exchange Act). The proposed exemption is intended to provide issuers with greater access to investment capital subject to appropriate investor protections, and to establish clear lanes for both registered broker activity and limited activity by Finders who would be exempt from registration. The SEC has requested comment on the proposed exemption by November 12, 2020.

### **Proposed Exemptions for Tier I Finders and Tier II Finders**

The SEC proposes to exempt from broker registration two classes of Finders: Tier I Finders and Tier II Finders. The proposed exemption for both Tier I and Tier II Finders would be available only when the following seven conditions are 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 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 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 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 as defined under Section 3(a)(18) of the Exchange Act; and
- 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 Finders**

A Tier I Finder would be defined as a Finder who meets the relevant conditions above and whose activity is limited to providing contact information of potential investors with only one capital-raising transaction by a single issuer within a 12-month period,<sup>2</sup> provided the Tier I Finder does not have any contact with the potential investors about the issuer. The contact information may include, among other things, name, telephone number, email address and social media information. Limiting the exemption to this activity is intended to narrow the role of the Tier I Finder to preclude the

participation in continuous or multiple sales of securities by persons who are not subject to broker-dealer registration. A Tier I Finder who complies with all the conditions of the exemption may receive transaction-based compensation for the limited broker-dealer services described above without being required to register as a broker under Section 15(a) of the Exchange Act.

## **Tier II Finders**

The SEC also proposes an exemption for Tier II Finders that would permit Tier II Finders to engage in additional solicitation-related activities beyond those permitted for Tier I Finders. A Tier II Finder is defined as a Finder who meets the relevant conditions above and who engages 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.<sup>3</sup> The SEC generally views solicitation as any affirmative effort to induce or attempt to induce a securities transaction and broadly views these activities of Tier II Finders to constitute solicitation. The SEC states that limiting the proposed exemption to these specified activities associated with solicitation, along with the additional conditions set forth below, is intended to narrow the role of the Tier II Finder to support the proposed exemption.

A Tier II Finder wishing to rely on the proposed exemption also would need to satisfy certain disclosure requirements and other conditions.<sup>4</sup> First, the Tier II Finder would need to provide a potential investor, prior to or at the time of the solicitation, disclosures that include:

- the name of the Tier II Finder;
- the name of the issuer;
- the description of the relationship between the Tier II Finder and the issuer, including any affiliation;
- 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;
- any material conflicts of interest resulting from the arrangement or 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.

The SEC proposes to allow a Tier II Finder to provide the above disclosures orally, provided that the oral disclosure is supplemented by written disclosure no later than the time of any related investment in the issuer's securities. The written disclosures can be provided through either paper or electronic means.

Second, the Tier II Finder also 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. The written acknowledgment may be provided through either paper or electronic means.

A Tier II Finder who complies with all the conditions of the proposed exemption may receive transaction-based compensation for services provided in connection with the activities described above without being required to register as a broker under Section 15(a) of the Exchange Act.

## **Prohibited Activities for Finders**

The proposed exemption would apply only with respect to the defined activities for each tier of Finder and is limited to activities solely in connection with primary offerings. A Finder could not rely on this proposed exemption to engage in broker activity beyond the scope of the proposed exemption. For example, a Finder could not:

- be involved in structuring the transaction or negotiating the terms of the offering;
- handle 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 for such purchases; and
- provide advice as to the valuation or financial advisability of the investment.

### **Safe Harbor**

The proposed exemption would provide a nonexclusive safe harbor from broker registration for Tier I and Tier II Finders. No presumption would arise that a person has violated Section 15(a) of the Exchange Act if such person is not within the terms of the proposed exemption. Consistent with how questions under Section 15(a) have been evaluated, whether a person is acting as a “broker” and in particular, whether he or she is “engaged in the business” of effecting securities transactions for the account of others will depend on the facts and circumstances of the particular matter. Accordingly, engaging in some of the limited activities falling within the terms of the proposed exemption should not be considered per se to require registration as a broker-dealer if all the requirements of the exemption are not met.

### **Other Applicable Laws**

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 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. Further, regardless of whether or not a Finder complies with this exemption, that Finder may need to consider whether he or she is acting as another regulated entity, such as an investment adviser or a municipal advisor. 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 if such person is acting as an investment adviser.

### **Request for Comment**

The SEC posed 45 specific questions regarding the proposed exemption. In addition to requests for comments on the various aspects of the proposal, the SEC inquired more broadly as to whether there are other areas in which the SEC should provide guidance regarding the applicability of broker-dealer registration requirements to other types of limited-purpose broker-dealers. The SEC also asked whether any staff no-action letters should or should not be withdrawn if the proposed exemption is adopted. Moreover, the SEC asked whether the proposed exemption would have a competitive impact on registered broker-dealers.

1. Securities Exchange Act Release No. 90112 (Oct. 7, 2020), 85 Fed. Reg. 64542 (Oct. 13, 2020) (available at <https://www.sec.gov/rules/exorders/2020/34-90112.pdf>).
2. The SEC noted that this requirement is similar to the limitation included in Rule 3a4-1 for sales activities by associated persons of an issuer. See Rule 3a4-1(a)(4)(ii)(C) under the Exchange Act (stating that as a condition of the rule, subject to limited exceptions, the associated person of an issuer cannot participate in selling and offering of securities for any issuer more than once every 12 months).
3. A Tier II Finder is not subject to the Tier I Finder's limitation of participating in only one capital-raising transaction by a single issuer in a 12-month period.
4. The disclosure requirements and conditions applicable to Tier II Finders differ from the requirements applicable to solicitors under the SEC's proposed amendments to Rule 206(4)-3 under the Investment Advisers Act of 1940, the Cash Solicitation Rule. See Investment Advisers Act Release No. 5407 (Nov. 4, 2019), 84 Fed. Reg. 67518 (Dec. 20, 2019). The SEC stated that 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.

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