

SEC PROPOSES LIMITED EXEMPTION FOR PERSONS ACTING AS “FINDERS” IN PRIVATE CAPITAL TRANSACTIONS TO ACCREDITED INVESTORS

Oct 08, 2020

The SEC [announced](#) on October 7, 2020 that it had approved, by vote of 3-2, a proposed limited conditional exemption for individuals acting as “finders” in private market transactions with accredited investors. The text of the proposed exemption can be found [here](#).

When small businesses engage in capital raising transactions in reliance on exemptions from registration under the Securities Act of 1933 (the “1933 Act”), they often look to “finders” to assist in identifying and, in some cases, soliciting potential investors. Such finders (and issuers using them) must determine whether they are required to register as “broker dealers” under the Securities Exchange Act of 1934 (the “1934 Act”). In making that assessment, finders and issuers (and their legal counsel) have been left to parse through various no-action letters and SEC enforcement actions to discern the SEC’s regulatory position. In that context, certain activities, as well as the presence of “transaction-based compensation” in these arrangements, have proved to be particularly nettlesome. The proposal would provide a non-exclusive safe harbor from broker registration, and would enable those who qualify to receive transaction-based compensation.

The proposal would be limited to natural persons, and would create two categories: Tier I Finders and Tier II Finders. Both tiers would be subject certain conditions:

- the issuer must not be required to file reports under the 1934 Act and must be conducting the offering in reliance on an applicable exemption from registration under the 1933 Act;
- the finder must not engage in a “general solicitation” under the securities laws and potential investors must be (or the finder must have a reasonable belief that potential investors are) “accredited investors” under Regulation D of the 1933 Act;
- the finder must provide his or her services pursuant to a written agreement with the issuer describing both the services provided and associated compensation; and
- the finder must not be an associated person of a broker-dealer and must not be subject to statutory disqualification under the 1934 Act at the time of his or her participation in an

offering.

Under the SEC proposal, Tier I Finders would be limited to a narrower range of activities than Tier II Finders, and could only provide contact information of potential investors and could not have any contact with them about the offering. Tier I Finders would be limited to participating in a single capital raising transaction by a single issuer in a 12-month period. This more or less reflects the current staff interpretive position on finders.

Tier II Finders, however, would be permitted to solicit investors on behalf of the issuer. While there are some limitations, a Tier II Finder would still be able to identify, screen, and contact potential investors; distribute issuer offering materials and discuss those material with investors; and arrange and participate in meetings with the issuer and an investor. Under the proposal, Tier II Finders would not be permitted to engage in certain activities: they could not be involved in structuring or financing the transaction, could not handle customer funds, and could not provide advice as to the valuation or financial advisability of the investment for an investor.

Because of this wider range of activity, Tier II Finders would also be required to provide disclosure of his or her role and compensation prior to or at the time of the solicitation and must obtain from the investor a dated written acknowledgment of receipt of the required disclosures prior to or at the time of any investment in the issuer's securities.

The proposal would not provide a safe harbor from compliance with other laws, including federal antifraud laws (Section 10(b) and Rule 10b-5) and state law.

Notably, Commissioners Lee and Crenshaw dissented from the proposal, while praising the work of the staff nonetheless in tackling an acknowledged gray area in the securities laws. [Commissioner Lee](#) noted that Tier II Finders would, as a result of the permitted activities, retain the "quintessential 'salesman's stake' in a potential transaction" and would be able to avoid registration by simply "refrain[ing] from concluding the presentation with the words 'you should invest.'" Commissioner Lee also noted that the proposal made it clear that Regulation BI (Best Interest) would not apply to such finders, and that the exemptive order process "effect[ed] an end-run around the rulemaking process, including the requirement that the Commission support its policy choices with empirical evidence and consider the effects of [its] actions on efficiency, competition, and capital formation."

[Commissioner Crenshaw](#) objected on two grounds: first, that the SEC is encouraging activity in private markets without sufficient visibility into how such markets operate, and second, that the proposal eliminates important investor protections embedded in the broker-dealer framework in an area "that is already prone to fraud." In addition, both Commissioners Lee and Crenshaw noted the absence of record-keeping requirements and examination authority by utilization under the proposal.

The SEC majority, including [Commissioners Peirce](#) and [Roisman](#), supported the changes as facilitating capital formation by small businesses by clarifying the ground rules relating to use of

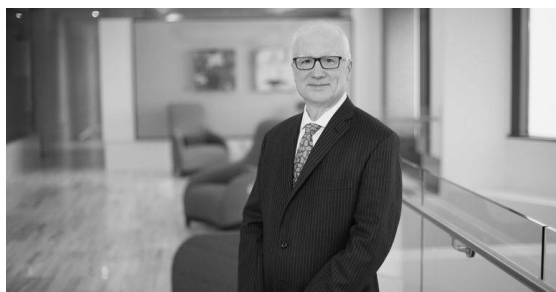
finders.

There will be a 30-day comment period for the proposed exemption following publication in the Federal Register. The SEC also prepared an [overview chart](#) showing a comparison of permitted activities and limitations for Tier I Finders, Tier II Finders and registered broker-dealers.

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