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Insights

THE SEC PROPOSES LIMITED RELIEF FOR SMALL BUSINESSES AND PERSONS INVOLVED IN PRIVATE CAPITAL TRANSACTIONS

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SUMMARY

A lack of regulatory clarity inhibits small businesses from engaging finders and cuts off meaningful access to the capital markets. New proposals from the U.S. Securities and Exchange Commission are subject to review, but it seems that change is on the way.

Small businesses that need to raise capital typically lack access to robust capital raising networks and often rely on "finders" for introductions to potential investors. The current federal and state regulatory landscape regarding compensating finders and determining whether finders are required to register as brokers is complex. In October 2020, the SEC proposed a new, limited, conditional exemption from broker registration requirements for finders (the "Proposed Exemption"). The proposals are still subject to further SEC review, but it would appear that change is afoot.

The Proposed Exemption would create a non-exclusive safe harbour from broker registration for finders, thereby allowing issuers to compensate these individuals with transaction-based compensation provided these finders engage in certain limited activities. There are two proposed "Tiers" of finder:

- **Tier I Finders** will be limited to providing contact information of potential investors in connection with only one capital raising transaction by a single issuer within a 12-month period, provided that the Tier I Finder does not have any contact with the potential investors about the issuer.
- **Tier II Finders** may engage in a wider range of solicitation-related activities on behalf of an issuer but these 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 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.

The Proposed Exemption is a step in the right direction for issuers that want to follow the rules and it provides participants in these arrangements greater regulatory clarity than exists today. However, this exemptive relief does not lessen the responsibilities for issuers' legal and compliance professionals and it does not completely eliminate the regulatory uncertainty inherent in these arrangements.

Eric Chartan and Andrew Adams wrote about this in our Emerging Themes in Financial Regulation 2021 publication.

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