

advisory

SEC PROPOSES CONDITIONAL EXEMPTION FROM BROKER REGISTRATION REQUIREMENTS FOR CERTAIN “FINDERS”

On October 7, 2020 the Securities and Exchange Commission (the “SEC”) proposed a new conditional exemption from the broker registration requirements for certain “finders” who assist small businesses in capital raising transactions involving only accredited investors. If adopted, this new exemption would permit natural persons to engage in certain limited activities without first registering with the SEC as securities brokers. The SEC is soliciting comments to the proposed new exemption for a thirty (30) day period following publication in the Federal Register.

Background

In general terms, federal securities laws require that persons and entities engaged in the business of “effecting securities transactions” must register as broker/dealers unless an exemption from the registration requirements applies. A significant body of law has developed over the years interpreting what constitutes “effecting securities transactions” and the courts have developed a multi-factor test to determine whether the party assisting in the capital raising activities is effecting securities transactions or, as typically alleged by the party, the activities are sufficiently limited that the person is really just a “finder.” Not surprisingly, the factor that is given the most weight in this analysis is whether the finder’s compensation is tied to the success of the capital raising transaction. Most often, this takes the form of a percentage of the capital raised by the “finder.” As a practical matter, if the answer to that question is yes, the SEC will almost certainly take the position that the finder is required to register as a securities broker.



Summary of Proposed New Rules

The proposed exemption from the registration requirements for securities brokers would create two classes of exempt finders: Tier 1 Finders and Tier 2 Finders. Both classes of finders would be permitted to accept performance or success-based compensation (e.g. a percentage of capital raised). However, the permissible involvement of Tier 1 Finders would be very limited. In essence, they would only be permitted to provide contact information for potential investors in connection with one capital raising transaction by a single issuer of securities in a twelve (12) month period. They could not have any contact with the potential investor about the issuer.

The requirements for Tier 2 Finders are far less restrictive. They would be permitted to solicit investors but their activities would be limited to (a) identifying and contacting potential investors; (b) distributing offering materials to potential investors; (c) discussing information about the company seeking to raise capital provided the information is included in the offering materials, and (d) participating in meetings between the company and potential investors. However, Tier 2 Finders would be prohibited from providing advice on the valuation or advisability of investment in the company.

Both Tier 1 and Tier 2 Finders would also have to adhere to the following requirements:

- The Finder cannot engage in a general solicitation of investors.
- The investor must be an accredited investor or the Finder must reasonably believe the potential investor is an accredited investor, as defined in Rule 501 of Regulation D.
- The company is seeking to conduct the securities offering in reliance on an applicable exemption from registration under the Securities Act of 1933, as amended (e.g., Regulation D, Section 4(a)(2) of the Securities Act, etc.).
- The Finder provides services pursuant to a written agreement with the company issuing the securities that includes a description of the services to be provided and the compensation to be paid to the Finder.
- The Finder is not an associated person of a broker-dealer.
- The company is not required to file reports under Sections 13 or 15(d) of the Exchange Act.
- The Finder is not subject to statutory disqualification at the time of his or her participation in the offering. (See Section 3(a)(39) of the Exchange Act)

Some Practical Advice

Keep in mind that this exemption has not been adopted as yet and may be subject to material changes after the comment period and prior to final adoption. Also, many state securities laws have their own rules regarding registration of securities brokers, and it remains to be seen whether the new federal exemption, if and when adopted, will preempt those state rules. If you have questions about this issue or other business matters, please contact PLDO Partner William F. Miller at 508-420-7159 or email wmiller@pdlolaw.com.



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