

SEC Proposes Finders Exemption

WRITTEN BY

[John P. Falco](#) | [Bruce K. Fenton](#) | [John M. Ford](#) | [Robert A. Friedel](#) | [Gregory J. Nowak](#)

RELATED OFFICES

[New York](#) | [Philadelphia](#)

At the [October 7, 2020 open meeting of the Securities and Exchange Commission \(SEC\)](#), Chairman Jay Clayton announced that the Staff of the Commission proposed to grant exemptive relief, permitting natural persons to engage in certain limited activities for issuers (Finders), without registering as brokers under Section 15 of the Exchange Act.

The proposed exemption designates two new classes of Finders: Tier I and Tier II. Those that narrow their activities to align with the proposal can avoid registering as a registered representative of a broker dealer and still receive transaction-based compensation. See [text of the proposed order](#). The staff also prepared a [concise chart](#) that compares Tier I Finders, Tier II Finders, and traditional broker dealers, covering permitted/nonpermitted activities, as well as payment options and by whom.

First, only natural persons can be Finders under the proposed order; a Finder's LLC or other company is not eligible. That makes sense because the SEC views a broker-dealer license as unique to the entity and considers the persons who generate the activity and profits as its registered representatives.

Second, the Finder must know or have a reasonable belief that the person being solicited is an accredited investor. The proposal requires the Finder to follow traditional paths to form that reasonable belief before undertaking a solicitation.

Third, the proposal shows the Commission's recognition that accredited investors provide the lion's share of growth capital for small businesses in the modern capital markets, and small businesses often find it difficult without the help of a Finder to reach those accredited investors.

The proposed exemption for Tier I and Tier II Finders are available only where:[\[1\]](#)

- The issuer is not required to file reports under Section 13 or Section 15(d) of the Exchange Act (e., the issuer is a private, nonreporting company);
- The issuer aims to conduct the securities offering relying on an applicable exemption from registration under the Securities Act (any offering exempt under the Securities Act of 1933 should be eligible, including those conducted under Section 4(a)(2) of the Securities Act, as well as those under the Regulation D safe-harbor; Regulation A and Regulation A+ offerings entail some form of general solicitation, and Regulation CF offerings

require a registered crowd funding portal, making them ineligible under this proposed exemptive order);

- The Finder does not engage in general solicitation (which implicitly means that the Finder cannot participate in a JOBS Act Rule 506(c) offering of the issuer since that would involve a 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 under a written agreement with the issuer that includes a description of the services provided and associated compensation (in this regard, the Finders under the proposal would look a lot like a “third-party solicitor” under the Investment Advisers Act of 1940);
- The Finder is not an associated person of a broker dealer (if the Finder is an associated person of a broker, then the associated person status controls, and he/she cannot “sell away” as a Finder); and
- The Finder is not subject to statutory disqualification, as defined in Section 3(a)(39) of the Exchange Act, at the time of his/her participation.

Tier I Finders. For purposes of the proposed exemption, a “Tier I Finder” is a Finder who meets the above conditions 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, 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. The Commission preliminarily believes limiting the exemption to this activity will appropriately narrow the Tier I Finder’s role to preclude the participation in continuous or multiple sales of securities by persons not subject to broker-dealer registration or to the heightened requirements of Tier II Finders. A Tier I Finder who complies with all of the exemption’s conditions may receive transaction-based compensation for the limited services described above without being required to register as a broker under Section 15(a) of the Exchange Act.[\[2\]](#)

This is effectively a codification of the *Paul Anka* no-action letter (1991 SEC No-Act Lexis 925 (July 24, 1991)).

Tier II Finders. The Commission also proposes an exemption, permitting a Finder — if meeting certain conditions — to engage in additional solicitation-related activities beyond those permitted for Tier I Finders. For purposes of the proposed exemption, a “Tier II Finder” is a Finder who meets the above conditions, and who engages in solicitation-related activities for an issuer that are limited to: (1) identifying, screening, and contacting potential investors; (2) distributing issuer offering materials to investors; (3) discussing issuer information included in any offering materials, provided that the Tier II Finder does not provide advice about the valuation or advisability of the investment; and (4) arranging or participating in meetings with the issuer and investor. As discussed above, the Commission 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.[\[3\]](#)

Under the proposal, so-called Tier II Finders could identify, screen, and contact potential investors; distribute issuer offering materials to investors; discuss issuer information included in offering materials; arrange or

participate in meetings with the issuer and the investor; and participate in more than one capital raising transaction within a 12-month period. Tier I Finders may not engage in any of these activities (the last one is the most telling as it would effectively preclude someone from “being in the business” of being a Tier I Finder).

So how does one become a Tier II Finder?

While the proposal requires a written agreement for all Finders, Tier II Finders must satisfy certain additional written disclosure obligations. First, the Tier II Finder would need to provide a potential investor, prior to or at the time of the solicitation, disclosures that include: (1) the name of the Tier II Finder; (2) the name of the issuer; (3) the description of the relationship between the Tier II Finder and the issuer, including any affiliation; (4) a statement that the issuer will compensate the Tier II Finder for his/her solicitation activities, and a description of the compensation arrangement terms; (5) any material conflicts of interest resulting from the arrangement or relationship between the Tier II Finder and the issuer; and (6) 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.

This disclosure can be provided orally under the proposal, so long as written disclosure will follow soon after and before the investment in the issuer’s securities.

Also, the Tier II Finder must obtain an acknowledgement (on paper or electronically) from the investor that the investor has received the necessary disclosure. It is this disclosure and acknowledgement process that looks very much like the cash solicitation rule for third-party solicitors under the Investment Advisers Act of 1940 Rule 206(4)-3; however, the staff noted certain differences between the two regulatory regimes.

Practice Points

Before the reader burns his/her membership agreement with FINRA or sponsoring broker-dealer contract, a few observations are in order:

This is a proposed exemptive order, not a statutory change. It is not yet effective, subject to a comment period, and then subject to a vote by the full Commission. Over the years, many similar proposals have been offered with very significant industry advocates backing — but to no avail. This time, it is a staff proposal, which probably gives it an inside track. However, with the pending election, it is unlikely that this will be acted upon until January, especially if there is a change in Congress or the administration. So while promising, it remains just a proposal at this juncture. Further, if an order is issued, the final order may be substantially different than the proposed order.

Second, it is designed, if adopted, as a “nonexclusive safe harbor” — meaning if you don’t fit within the proposed exemption, you can still rely on current law if it covers your situation.

Third, if adopted, associated persons of a registered broker dealer cannot become Finders and obtain compensation outside of the broker-dealer structure — in other words, if you are a registered representative of a broker, the selling away prohibitions are alive and well.

Fourth, if adopted, the proposal would eliminate the federal “Section 15 Sword of Damocles” remedy — also

known as rescission — regarding those transactions, where an illegal Finder received transaction-based compensation under current law, which subjects the entire raise to a “rescission” risk under current law. State law — such as the New York Statute of Frauds that makes a broker’s claim for selling compensation illegal and unenforceable if not in writing, as well as California’s and Florida’s rights of rescission — would still apply. Moreover, Finders wanting to engage in activities beyond the scope of the proposed exemptive order would still need to become associated persons of a broker dealer in order to legitimately receive transaction-based compensation.

While definitely a step in the right direction, the proposal still has a long road ahead of it. In the meantime, please continue to apply the rules as currently written and interpreted.

[1] Bulleted content taken from the proposal’s text and annotated with our commentary.

[2] SEC Proposal (citations omitted).

[3] SEC Proposal (citations omitted).

RELATED INDUSTRIES + PRACTICES

- [Corporate](#)
- [Emerging Companies + Venture Capital](#)
- [Health Care Transactions](#)
- [Investment Funds + Investment Management Services](#)
- [Private Equity](#)