

PUBLICATION

SEC Proposes Broker Registration Exemption for Certain "Finders"

October 19, 2020

On October 7, 2020, the Securities and Exchange Commission (Commission) proposed a conditional exemption from the broker registration provisions of the Securities Exchange Act of 1934 (Exchange Act) for natural persons that engage in certain activities traditionally associated with "finders" in connection with capital-raising transactions. The exemption would be provided via an exemptive order issued by the Commission. Assuming compliance with the proposed conditions of the exemption, such finders could accept transaction-based compensation.

As noted in the proposing release with respect to the [exemptive order](#), concerns over the regulatory status of persons who play a limited role in connecting companies raising capital with potential investors has led to decades of calls for the Commission to address these issues from a wide variety of constituents.

If adopted, the proposed order would provide a non-exclusive safe harbor from the broker registration requirements of the Exchange Act for two classes of finders: "Tier 1 Finders" and "Tier II Finders." In each case, the exemption would be available only where:

- The issuer conducting the offering is not required to file reports under the Exchange Act;
- The offering is being conducted pursuant to an exemption from registration under the Securities Act of 1933 (Securities Act);
- The potential investors the finder refers to the issuer or contacts regarding the offering are, or the finder reasonably believes them to be, accredited investors, as defined in Rule 501 under the Securities Act;
- The finder does not engage in general solicitation of potential investors;
- The finder and issuer have entered into a written agreement that describes the services the finder will provide and his or her compensation for such services;
- The finder is not an associated person of a broker-dealer (as defined in Section 3(a)(18) of the Exchange Act); and
- The finder is not subject to a statutory disqualification, as defined in Section 3(a)(39) of the Exchange Act.

Tier 1 Finders would be limited to providing contact information of potential investors with respect to only one offering and a single issuer within any 12-month period.

Tier 2 Finders could engage in limited solicitation-related activities, including

- Identifying, screening, and contacting potential investors;
- Distributing issuer-offering materials to investors;
- 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
- Arranging or participating in meetings with the issuer and investor.

A Tier II Finder would be required, however, to provide potential investors that he or she solicits, by the time of any solicitation, with prescribed disclosures, including

- His or her name and the issuer's name,
- The relationship, if any, between the finder and the issuer,
- A statement that the finder will be compensated for his or her solicitation activities and a description of such compensation arrangement,
- Any material conflicts of interest resulting from the arrangement or any relationship between the finder and the issuer, and
- A statement that the finder is acting as an agent of the issuer, is not acting as an associated person of a broker-dealer, and is not undertaking to act in the investor's best interests. While such disclosures could be provided orally initially, they would have to be provided in writing (including by electronic means) by the time of an investor's investment in the offered securities. In addition, the finder would be required to obtain from any investor he or she solicits, at or prior to the date of the investor's investment, a dated, written acknowledgement of receipt of such disclosures.

While the proposed release and the Commission's related press release, available [here](#), emphasize the role finders do and will continue to play in connecting small businesses with potential investors, the proposed exemptive order would not actually limit the class of issuers whose offerings may be covered by the exemption by public float, asset size, or otherwise.

Finders relying on the proposed exemption could not be involved in structuring or negotiating the terms of the offering. In addition, such a finder would be prohibited from:

- Handling customer funds or securities;
- Binding the issuer or an investor;
- Participating in preparing any sales materials;
- Performing an independent analysis of the sale;
- Engaging in due diligence activities;
- Assisting or providing financing for purchases of securities in the offering; or
- Providing advice as to the valuation or financial advisability of the investment.

Comments on the proposed exemption are due to the Commission by Thursday, November 12, 2020.

We emphasize that the proposed exemption discussed in this alert is just that, a proposal, and cannot be relied on at this time. Further, there is no guarantee that the proposed exemptive order will actually be issued. Finally, the proposed exemption from the broker registration requirements of the Exchange Act would not preempt or otherwise impact the need for finders to comply with broker, agent, salesman, or similar registration requirements of applicable state securities or "blue sky" laws, which would limit the usefulness of the proposed exemption unless the states follow suit or at least provide some registration relief with respect to the finder activities that would be covered by the proposed exemptive order.

For more information please contact any member of Baker Donelson's [Corporate Finance and Securities Group](#).