

## [Securities Regulation Daily Wrap Up, PRIVATE PLACEMENTS—State regulators ask SEC to put the brakes on finders exemption, \(Nov. 16, 2020\)](#)

Securities Regulation Daily

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NASAA and securities regulators from 30 states believe the Commission's proposed exemption from broker registration requirements will remove important investor protections from the private markets.

The North American Securities Administrators Association (NASAA) has asked the SEC to withdraw its proposal to exempt certain individuals who are compensated for locating potential investors in private offerings from the registration requirements of the Exchange Act. In a [comment letter](#) opposing the Commission's proposal to create a new federal broker-dealer exemption for these private placement "finders," NASAA President Lisa Hopkins wrote that the rule would expand the private market without providing any equivalent effort to protect investors from the enhanced risk of fraud in an area that remains prone to abuse. Separately, the chief securities administrators of 30 states [joined](#) NASAA in opposing the SEC's proposal, writing that rulemaking that facilitates unlicensed intermediaries in the private market runs directly counter to the public interest.

On October 7, 2020, the SEC voted 3-2 to [propose](#) a limited, conditional exemption from broker registration requirements for "finders" who assist issuers with raising capital in private markets from accredited investors. The [proposed exemption](#) from the broker registration requirements of Exchange Act Section 15(a) would permit natural persons to engage in certain limited capital raising activities involving accredited investors. The proposal would create two classes of exempt finders—Tier 1 finders and Tier 2 finders—and sets forth conditions tailored to the activities of each tier that would permit eligible persons to accept transaction-based compensation for their fundraising efforts.

**Regulatory vacuum.** NASAA reminded the SEC it has repeatedly informed the Commission of the prevalence of abuse in the private market, noting that state enforcement actions against unregistered persons have more than doubled since 2015. NASAA also cited a study of fraud published in August 2020 by the SEC's the Commission's Division of Economic and Risk Analysis (DERA), in which the staff observed that "fraud is more likely to occur when there are fewer outside gatekeepers like underwriters, analysts and regulators." The expresses precisely NASAA's concern with the proposal, Hopkins wrote, because "it would remove regulatory oversight from the persons most likely to engage in misconduct in the situations in which fraud and other violations are most likely to occur."

NASAA took no comfort in the proposal's assurance that finders would not be excused from the antifraud provisions of the federal securities laws and "other applicable laws." NASAA observed that the proposal would exempt persons who would otherwise be required to register as broker-dealer representatives from important oversight requirements imposed by FINRA and other SROs. The benefits of SRO oversight that would be lost include examinations to establish minimal competency to deal with investors; background checks that capture circumstances such as bankruptcies and liens; continuing education requirements; recordkeeping requirements; and customer dispute mechanisms. The proposal would also undermine efforts by state regulators and the SROs to develop systems to help investors identify problematic intermediaries by exempting finders from registration and its attendant recordkeeping systems, Hopkins wrote, and may even attract persons whose disciplinary records make them unemployable by reputable firms.

NASAA took the SEC to task for ignoring previous recommendations to coordinate an exemptive framework with state securities regulators, including a 2005 report by the American Bar Association's Task Force on Private Placement Broker-Dealers, which recommended that federal and state regulators should "work to establish a simplified system of registration" for finders. This recommendation was further supported by the SEC's

Advisory Committee on Small and Emerging Companies, which recommended similar measures in letters to the Commission in 2015 and 2017. In addition, the 2017 Treasury Department Report cited in the SEC's proposal also recommended that the SEC, FINRA, and the states develop and implement a new "broker-lite" regulatory regime on finders.

In NASAA's view, these previous recommendations in favor of registration make sense because finders engage in activities which are core broker-dealer activities, including introducing investors to issuers, evaluating investors for suitability, and receiving transaction-based compensation. Moreover, as state law requirements would continue to apply, state securities regulators will need to respond to a newly-created regulatory vacuum. "Given previous recommendations to coordinate and previous communications with the staff on this issue, state securities regulators are surprised to the point of alarm; the Commission gave no clear signal that it was considering abandoning regulation in this area," Hopkins wrote.

If the SEC chooses to implement an exemptive order, NASA suggested that the Commission should, at a minimum, make the following changes:

- Finders should be required to conduct due diligence on the issuers they promote.
- The exemption should apply only to natural persons.
- Only U.S. residents should be allowed to be exempted.
- Finders should be limited to primary offerings.
- The exemption should define the conflicts of interest that a finder would be required to disclose.
- Finders should be more clearly prohibited from conducting general solicitation by being required to solicit only persons with whom they have a substantial, pre-existing relationship.
- The written disclosures must be clarified and strengthened, making clear that the finder must disclose: the amount of compensation he or she is receiving from an issuer, regardless of the form; any relationship or affiliation with any officer or director of the issuer; and any prior regulatory or disciplinary action taken against the finder by a financial regulator.

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