

[Securities Regulation Daily Wrap Up, TOP STORY—Commission proposes conditional exemption from broker registration for finders, \(Oct. 7, 2020\)](#)

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Proposal is intended to assist small businesses in raising capital by clarifying the limited activities in which finders may engage without registering.

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. Finders identify and sometimes solicit potential investors in order to connect small businesses with investors in the private placement market, especially in regions without robust capital raising networks.

Chairman Jay Clayton [noted](#) that for many small businesses the private markets may be their only source of growth capital, but smaller businesses and investors often have trouble connecting with each other in the private market. In his view, finders can help bridge the gap between small businesses that need capital and investors who want to support emerging enterprises.

The proposal addresses the lack of clarity regarding the regulatory status of finders, according to Clayton, who said the agency has received requests for guidance in this area for decades. Commissioner Allison Herren Lee, who opposed the proposal, [said](#) that claiming that the agency is taking these steps in the name of clarity is misleading because the proposal requires no form of recordkeeping from finders.

Two classes of finders. The [proposed exemption](#) from the broker registration requirements of 1934 Act Section 15(a) would permit natural persons to engage in certain limited capital raising activities involving accredited investors. It would create two classes of exempt finders—Tier 1 finders and Tier 2 finders—and lays out conditions tailored to the activities of each tier. Both Tier 1 and Tier 2 finders would be permitted to accept transaction-based compensation under the proposed exemption.

The proposal provides that a Tier 1 finder is limited to providing contact information of potential investors in connection with only a single capital raising transaction by a single issuer in a 12-month period. In addition, a Tier 1 finder could not have any contact with a potential investor about the issuer.

Tier 2 finders may solicit investors on behalf of an issuer, but the solicitation-related activities would be 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 2 finder does not provide advice as to the valuation or advisability of the investment, and 4) arranging or participating in meetings with the issuer and investor.

Both Tier 1 and Tier 2 finders would be subject to the condition that the exemption is only available where:

- the issuer is not required to file reports under 1934 Act Section 13 or Section 15(d);
- the issuer is seeking to conduct the securities offering in reliance on an applicable exemption from 1933 Act registration;
- the finder does not engage in 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 pursuant to a written agreement with the issuer that includes a description of the services provided and associated compensation;
- the finder is not an associated person of a broker-dealer; and

- the finder is not subject to statutory disqualification, as that term is defined in 1934 Act Section 3(a)(39), at the time of his or her participation.

The proposal also provides that a finder could not rely on the exemption to engage in broker activity beyond the scope of the proposed exemption. In particular, a finder could not rely on the exemption to facilitate a registered offering, a resale of securities, or the sale of securities to investors that are not accredited investors or that the finder does not have a reasonable belief are accredited investors.

In addition, a finder may not be involved in structuring the transaction or negotiating the terms of the offering, handle customer funds or securities or bind the issuer or investor or participate in the preparation of any sales materials. A finder also may not perform any independent analysis of the sale, engage in any "due diligence" activities, assist or provide financing for such purchases, or provide advice as to the valuation or financial advisability of the investment.

More Tier 2 conditions. The Commission [stated](#) that because Tier 2 finders can participate in a wider range of activity and have the potential to engage in more offerings, additional requirements are proposed. A Tier 2 finder wishing to rely on the proposed exemption would need to satisfy certain disclosure requirements and other conditions. The disclosure requirements, which include a requirement that the Tier 2 finder provide appropriate disclosures of its role and compensation, must be made prior to or at the time of the solicitation. Also, the Tier 2 finder must obtain from the investor, prior to or at the time of any investment in the issuer's securities, a dated written acknowledgment of receipt of the required disclosures.

Clayton supported the proposal, which he believes is narrowly tailored to address the capital formation needs of entrepreneurs and certain smaller issuers while preserving investor protections. He encouraged public comment on the proposal, especially on whether the offering size should be capped.

Commissioners Hester Peirce and Elad Roisman also voted in favor of issuing the proposal. Peirce [praised](#) the staff for providing clear guidelines in an area that heretofore has relied on an ad hoc approach based on guideposts gleaned from no-action letters and enforcement actions. Roisman [agreed](#), adding that the exemption does not limit the enforceability of the antifraud provisions of the federal securities laws or the ability of the SEC to go after bad actors, whether they are finders or registered brokers.

Two commissioners dissent. Lee cautioned that the proposed exemption permits individuals to engage in traditional brokerage activity without the investor protections that come with registration as a broker-dealer, thereby creating a new category of unregistered financial professional. She said that she could have supported a proposal with a scaled registration format that required, at a minimum, some form of record keeping and examination authority.

She also is opposed to the fact that finders would not be subject to Reg. BI under the assumption that investor protection will not be undermined because finders may solicit only accredited investors. When the Commission adopted Reg. BI, she pointed out, it explicitly rejected the suggestion that accredited investors are less in need of the protections afforded by the rule.

Commissioner Caroline Crenshaw [said](#) that while she is not opposed to clarifying regulatory gray areas, she views the proposed exemption as a radical departure from established registration requirements. It would expand the scope of investor solicitation activities by unregistered and unsupervised agents in private markets, she noted. She believes the proposal continues the recent Commission trends of encouraging the growth of opaque private markets at the expense of the more transparent public markets, and eroding investor protections that are provided by the established regulatory framework.

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