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SEC Proposes Exemption from Registration for Finders

On Oct. 7, 2020, the U.S. Securities and Exchange Commission (SEC) held an open meeting and issued a notice proposing a conditional exemption from securities broker-dealer registration under Section 15 of the Securities Exchange Act of 1934 for “finders” who assist entrepreneurs and issuers in raising capital through private placements sold to accredited investors (the proposal). The proposal would create two tiers of finders who, if all conditions are satisfied, would allow such finders to be exempt from Section 15 registration requirements. They are:

- **Tier I Finder:** A Tier I Finder would be limited to providing to an issuer or its agent contact information of potential investors in connection with only a single capital-raising transaction by a single issuer in a 12-month period. A Tier I Finder could not have any contact with potential investors about the issuer.
- **Tier II Finder:** A Tier II Finder could solicit investors on behalf of an issuer, but the solicitation-related activities would be limited to: (i) identifying, screening, and contacting potential investors; (ii) distributing issuer offering materials to investors; (iii) 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 (iv) arranging or participating in meetings with the issuer and investor. A Tier II Finder must provide potential investors, prior to or at the time of the solicitation, disclosures of the Tier II Finder’s role and compensation. A Tier II Finder would also be required to

obtain from the investor prior to or at the time of any investment a written acknowledgement of the investors' receipt of the necessary disclosures.

Assuming all conditions are satisfied by a "finder," both Tier I and Tier II Finders can receive transaction-based (i.e., commission) compensation for his or her finder services without registering as a securities broker or dealer or an associated person of a securities broker or dealer. However, no finder may be involved in structuring the transaction or negotiating the terms of the offering, handling customer funds or securities, participating in the preparation of any sales materials, performing any independent analysis of the sale, performing any due diligence activity, assisting or providing financing for investors' purchases, or providing an evaluation of the advisability of the investment.

In order to take advantage of this exemption, a finder and an issuer must have a written agreement that includes a description of the services provided and associated compensation, and the finder cannot engage in general solicitation activities, be an associated person of a broker-dealer, or be subject to statutory disqualification at the time of his/her participation. The proposed exemption appears to be modeled on a longstanding solicitation rule under the Investment Advisors Act of 1940.

SEC Chairman Clayton noted that the regulatory status of finders is a longstanding issue, and over the years there have been many calls for Commission action in this area. Commissioners Hester Peirce and Elad Roisman supported the proposal. Commissioners Allison Herren Lee and Caroline Crenshaw did not support the proposal. Commissioner Lee pointed out the proposal would permit individuals to engage in traditional brokerage activity without the investor protections that come with registration as a broker-dealer, thus creating a new category of unregistered financial professionals. Commissioner Crenshaw described the proposal as a radical departure from established registration requirements which would deregulate core broker-dealer activities and erode investor protections.

There will be a 30-day public comment period once the proposal is published in the Federal Register.

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