



## Financial Services & Products ADVISORY ■

**OCTOBER 7, 2020**

### SEC Proposes New Exemptive Relief for Finders

The Securities and Exchange Commission (SEC) has [proposed](#) an important new exemptive order that would clarify and expand the ambiguous, decades-old “finders” exception from broker-dealer registration. This new exemption, if ultimately approved, could provide much needed, and long overdue, guidance for issuers seeking greater ability to find and access sources of capital. This proposal follows repeated requests in the past two decades from various industry stakeholders for clarity in this area and comes amid a wider effort by the SEC to broaden access to investment funds, for example the [SEC concept release](#) in June 2019 that resulted in [amendment of the “accredited investor” definition](#) described in a previous [advisory](#).

The proposal will be of particular interest to sponsors of private investment funds because if implemented, it would provide greater certainty for sponsors that are seeking additional sources of capital from alternative distribution channels beyond registered broker-dealers.

The proposal, which was approved October 7, 2020 by an SEC vote of 3–2, would create a limited, two-tier exemption for individuals who are paid to serve as intermediaries, i.e., “finders,” who connect private issuers conducting offerings exempt from SEC registration with potential investors who are, or who the finder reasonably believes to be, “accredited investors” under Rule 501 of Regulation D of the Securities Act of 1933, as amended. Notably, the proposal would permit individuals operating in either tier to receive transaction-based compensation, which has historically been regarded by the SEC as a strong indicator of activity requiring broker-dealer registration.

#### **General Requirements**

Anyone aspiring to be a finder would need to meet certain general conditions, namely:

- The issuer for which the finder is acting must be non-reporting (i.e., not required to file reports under Section 13 or Section 15(d) of the Securities Exchange Act of 1934, as amended), and the offering must be a private offering (i.e., exempt from registration under the Securities Act).
- The finder cannot engage in general solicitation (as referenced in the proposal, whether marketing constitutes general solicitation has generally been reviewed by the SEC as a “fact-specific determination” and is not otherwise defined in the proposal; however, the proposal notes that one way to “demonstrate the absence of general solicitation is by establishing the existence of a pre-existing substantive relationship” with the investor).
- The potential investor must be, or the finder must reasonably believe them to be, an accredited investor (as defined in Rule 501 of Regulation D of the Securities Act).

- The finder's services are documented in a written agreement between the issuer and finder, including a description of the services and related compensation.
- The finder must be a natural person and cannot be an "associated person" of a broker-dealer as defined in Section 3(a)(18) of the Exchange Act, nor can they be subject to statutory disqualification as defined in Section 3(a)(39) of the Exchange Act.

In addition, a finder relying on the exemption could not engage in any additional brokerage-related activities that exceed the scope of the safe harbor being provided by the proposal, including any activities related to a registered offering or resale of securities. Moreover, a finder could not "(i) be involved in structuring the transaction or negotiating the terms of the offering; (ii) handle customer funds or securities or bind the issuer or investor; (iii) participate in the preparation of any sales materials; (iv) perform any independent analysis of the sale; (v) engage in any 'due diligence' activities; (vi) assist or provide financing for such purchases; or (vii) provide advice as to the valuation or financial advisability of the investment."

## Tier I Finders

The first tier of the proposed exemption is largely consistent with the most well-known of existing SEC guidance on who may act as a finder without broker-dealer registration. Similar to the nearly 30-year-old SEC no-action letter involving singer Paul Anka—who the SEC permitted to receive a finder's fee, without registering as a broker-dealer, for providing a list of his personal contacts to an NHL ownership group looking to raise capital—the new "Tier 1" exemption would permit a finder to receive transaction-based compensation, provided that their activities are restricted 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," and the finder does not have any contact with the potential investor about the issuer (a "Tier 1 Finder").

## Tier II Finders

The new Tier II exemption contained in the proposal represents a more expansive view compared to what was covered by historic SEC guidance around the finders exception, and as noted by the two dissenting commissioners, would cover activity that has historically been viewed by certain regulators, including the SEC, as indicative of activity requiring broker-dealer registration.

Compared to a Tier I Finder, a Tier II Finder would not be subject to the frequency and time limitations imposed on a Tier 1 Finder and would be permitted to engage in an expanded range of solicitation-related activities, including: "(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").

In exchange for these expanded abilities, Tier II Finders are subject to additional requirements, including required written disclosures regarding the finder's role and compensation that must be made to the investor at or before the time of the solicitation. In addition, the Tier II Finder would have to obtain a written dated acknowledgement from the investor regarding their receipt of those disclosures, at or before the time of any investment. Importantly, the SEC acknowledges that Tier II Finders would not be subject to the new "best interest" standard of conduct that applies to securities recommendations made by broker-dealers.

## Conclusion

The proposal would provide some much-needed clarity to funds and other businesses that seek wider access to capital through a variety of intermediaries, including those who are not financial services professionals by trade or licensure. While the proposed safe harbor for Tier 1 Finders largely tracks with prior SEC guidance on the very narrow historic finders exception, the proposed exemption for Tier II Finders would significantly expand the ability of non-licensed marketers and capital raisers to facilitate capital raises for private issuers. As acknowledged in the proposal, however, the Tier II Finders exemption will leave in place many of the historic risks that issuers and unregistered intermediaries must manage, specifically how to identify the demarcation point between exempt “finders” activities and more traditional brokerage activities requiring registration with the SEC.

As noted by one of the dissenting commissioners, because the proposal is in the form of an exemptive order, and not a proposed rule, it bypassed several key hurdles of the rulemaking process, which requires detailed presentation of empirical evidence and economic analysis and consideration of the impact on efficiency, competition, and capital formation. As a result, SEC action on the proposal could potentially occur faster than the timeframe expected under a traditional rule proposal; therefore, prompt input from industry participants is essential.

The SEC has invited the public to provide comments to a list of questions included in the proposing notice, including the types of persons, activities, and offerings that it covers in its proposed form. Any comments will need to be submitted within 30 days of the notice’s publication in the *Federal Register*. We would welcome the opportunity to hear your views, so please reach out with any questions or thoughts you might have, and to assist any industry participants in preparing comments to the proposal.

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