

ALERTS

SEC Proposes Limited Exemption for Finders

October 9, 2020

On Oct. 7, 2020, the SEC, by a 3-2 vote, proposed a conditional exemption from the broker-dealer registration requirements of Section 15(a) of the Securities Exchange Act of 1934, as amended (“Exchange Act”), for natural persons who assist issuers with raising capital in private markets from “accredited investors” (“Proposal”). The Proposal provides long-sought guidance regarding payment of transaction-based compensation to unregistered persons, commonly referred to as “finders,” who engage in limited securities-related activities to raise funds on behalf of issuers.

The Proposal creates two classes of finders, based on the types of activities in which they are permitted to engage, that would qualify for an exemption from registration. A Tier I finder would be permitted to provide a list of potential investors in connection with a single capital raising transaction by a single issuer once every 12 months. Tier I finders may not communicate with investors regarding an investment opportunity. A Tier II finder would be permitted to solicit investors on behalf of an issuer, distribute offering materials to investors, discuss issuer information included in offering materials and participate in meetings with the issuer and investors. Both Tiers of finders would be permitted to receive transaction-based compensation, which has traditionally been considered a hallmark of brokerage activity.

Under the Proposal, both tiers of finders would have a non-exclusive safe harbor from broker registration provided that the finder’s activities are limited as described below. Importantly, while the Proposal allows finders to receive transaction-based compensation, it does not permit finders to

engage in other brokerage-related activities relating to distributions such as: (1) structuring the transaction; (2) negotiating the terms of an offering; (3) participating in the preparation of sales materials; and (4) providing advice regarding the valuation or financial advisability of the investment. Should a finder participate in any of these activities, the Commission notes that the finder may need to analyze whether it has implicated the registration requirements of Section 15 of the Exchange Act.

The proposed exemptions under both tiers would only be available when: (1) the issuer is seeking to conduct the securities offering in reliance on an applicable exemption from registration under the Exchange Act and is not required to file reports under Section 13 or Section 15(d) of the Exchange Act; (2) the potential investor is an “accredited investor” or the finder has a reasonable belief that the potential investor is an “accredited investor,” as defined in Rule 501 of Regulation D; and (3) the Finder is not an associated person of a broker-dealer or subject to statutory disqualification at the time of his or her participation^[1], provides services pursuant to a written agreement^[2] with the issuer and does not engage in general solicitation.

In the Proposal, the Commission discusses the important role of finders in capital formation and the need for such an exemption for small businesses that must raise capital, but not in amounts sufficient to attract either venture capitalists or the assistance of a registered broker-dealer. (The Commission identifies these businesses as those needing to raise less than \$5 million.) We note, however, that despite the targeted nature of the identified need, the Proposal does not appear to be similarly targeted. While the proposed exemption is limited to accredited investors and private transactions, there was no discussion in the Proposal regarding an overall cap on funds raised, leaving the door open for larger issuers to avail themselves of the services of a finder that receives transaction-based compensation.

The Commission also solicits comment on a number of topics in the Proposal. Notably, the Commission seeks comment on a number of topics relating to private fund managers. Specifically, in question 30, the Commission asks whether the proposed exemption should “provide guidance regarding activities of private fund advisers[.]” In question 36, the Commission asks whether the proposed exemption should “be limited to individuals who are not associated persons of a municipal advisor or investment adviser representative of an investment adviser.” The

Commission also solicits comment regarding potential alignment of the disclosure requirements for Tier II finders and Rule 206(4)-3 of the Investment Advisers Act (“Cash Solicitation Rule”).

Finally, we note that because this relief would be issued in the form of an exemptive order rather than a rule, the Commission is not required to follow its formal rulemaking procedure in issuing this relief. Specifically, the Commission is not required to perform any economic analysis of the impact of the exemption or consider its impact on capital formation. Relatedly, because the Commission is not required to follow its formal rulemaking procedure, action on this proposal may occur more quickly.

Comments on the Proposal are due 30 days after publication in the Federal Register. If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

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[1] Statutory disqualification is defined in Section 3(a)(39) of the Exchange Act.

[2] Such written agreement must include a description of the services provided and associated compensation.

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