SEC Proposes Limited Exemption for Individual "Finders"

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On October 8, 2020, the Securities and Exchange Commission (the "SEC") voted to propose a new limited conditional exemption from broker registration requirements for "finders." The SEC's press release is accessible here. Under Section 15 of the Securities and Exchange Act of 1934, as amended (the "Exchange Act"), many persons that are considered "finders" are required to register as "brokers" or "dealers" with the SEC. However, if the proposed exemption is adopted, it would exempt individual finders from the broker registration requirements under the Exchange Act if such finders are engaged in certain limited capital raising activities involving accredited investors. According to the SEC, the purpose of the proposed exemption is "to assist small businesses to raise capital and to provide regulatory clarity to investors, issuers and the finders who assist them."

For many years, the regulatory status of finders has been a recurring issue for small businesses attempting to access the private capital markets. "Many small businesses face difficulties raising the capital that they need to grow and thrive, particularly when they are located in places that lack established, robust capital raising networks," noted SEC Chairman Jay Clayton. "Particularly in these ecosystems, finders may play an important role in facilitating capital formation for smaller issuers." The SEC's proposed exemption would provide clarity regarding what activities a natural person that is acting as a finder may engage in without triggering any broker registration requirements.

As proposed, the exemption would create two tiers of finders, each of which would be subject to specific conditions related to the scope of their activities, where:

- "Tier I finders" may provide an issuer with the contact information of potential investors in connection with a single capital raising transaction by a single issuer in a 12-month period, but may not have any contact with a potential investor about the issuer; and
- "Tier II finders" may solicit potential 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.

The exemption will be available to both tiers of finders only when the following circumstances are satisfied:

- the issuer is not required to file reports under the Exchange Act (as a public company);
- the issuer is conducting the securities offering under an applicable exemption from registration under the Securities Act of 1933, as amended (the "Securities Act");
- the finder does not engage in general solicitation;
- the potential investor is, or the finder has a reasonable belief the potential investor is, an "accredited investor" as such term is defined in Rule 501 of Regulation D under the Securities Act;
- 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 as defined in Section 3(a)(18) of the Exchange Act; and
- at the time of his or her individual participation, the finder is not subject to "statutory disqualification" as such term is defined in Section 3(a)(39) of the Exchange Act.

A finder relying on the proposed exemption will not be permitted to engage in certain activities in connection with the transaction, including (i) structuring or negotiating the terms of the offering; (ii) handling customer funds or securities, or binding the issuer or investor to any transaction; (iii) participating in the preparation of any sales materials; (iv) performing any independent analysis of the sale; (v) engaging in any "due diligence" activities; (vi) assisting or providing financing for such purchases; or (vii) providing advice as to the valuation or financial advisability of the investment.

A Tier II finder is also required to provide potential investors, prior to or at the time of the solicitation, disclosures that include:

- the name of the finder;
- the name of the issuer;
- the description of the relationship between the Tier II finder and the issuer, including any affiliation;
- a statement that the Tier II finder will be compensated for his or her solicitation activities by the issuer and a description of the terms of such compensation arrangement;
- any material conflicts of interest resulting from the arrangement or relationship between the Tier II finder and the issuer; and
- an affirmative statement that the Tier II finder is acting as an agent of the issuer, is not acting as an associated person of a broker-dealer and is not undertaking a role to act in the investor's best interest.

The SEC also prepared a video and a chart outlining the permissible activities, requirements and limitations for Tier I finders, Tier II finders, and registered brokers.

The proposed exemption will be subject to a 30-day comment period following publication in the Federal Register.

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