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SEC Proposes Exemption from Broker Registration for Private Placement Finders

The Securities and Exchange Commission (the “Commission”) recently [proposed an exemption](#) from the broker-dealer registration requirements of Section 15(a) of the Exchange Act of 1934 (the “Exchange Act”) for “finders” who help issuers raise capital from accredited investors in private placements. If adopted, the proposed exemption would provide a clear path for a natural person who is not registered as, or associated with, a broker-dealer to receive transaction-based compensation in exchange for certain capital-raising activities, and would end decades of uncertainty surrounding the regulatory status of so-called “finders.” Such an exemption could prove useful for private fund sponsors and for other companies that seek to raise capital through a person who is not a broker-dealer registered with the Commission.¹

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Background

Although the term “finder” has not been defined in any Commission rule or statute, the term traditionally has been used to refer to a person who receives a fee for performing certain early-stage activities in a securities transaction, including “finding” potential buyers and/or sellers and connecting them with a counterparty. Finders typically take the view that they are not required to register as brokers under the Exchange Act because finders do not perform the more substantial activities that brokers perform, including advising investors on the merits of an investment opportunity, performing due diligence, negotiating the transaction, and/or participating in the execution of the transaction. Legal guidance in this area largely has been based on interpretations of decades of (in many cases inconsistent) no-action letters (and denials thereof) issued by the Commission staff, as well as Commission enforcement actions, which similarly have yielded inconsistent results. Accordingly, there has been little comfort for finders, as well as the issuers that engage finders, that the finders’ operations are compliant with applicable regulations.²

The Commission’s proposed exemption seeks to bring clarity to this uncertain area and to ease the burden of raising capital for small businesses.

The Proposal

The Commission’s order proposes to grant exemptive relief permitting a finder, without registering as a broker-dealer, to provide certain capital-raising services in connection with primary offerings that are exempt from registration under the Securities Act and to receive transaction-based compensation for these services. The proposed exemption could only be

¹ The proposed order addresses only Commission requirements for broker-dealer registration; it does not address any requirements arising under state laws, including state broker-dealer registration requirements and state finder requirements. Moreover, the proposed exemption would not affect a finder’s obligation to comply with other applicable laws, including the antifraud provisions of the Securities Act of 1933 (the “Securities Act”) and the Exchange Act.

² The issue of whether a finder should be registered as a broker-dealer has implications not only for the finder, but also for the issuer. For example, in 2013, the Commission filed an order instituting settled administrative and cease-and-desist proceedings not only against the unregistered finder, but also against the private equity firm Ranieri Partners (“Ranieri”) and a former Ranieri executive in connection with the unregistered finder’s solicitation of capital commitments for Ranieri private investment funds. The Commission alleged that the finder performed activities for which the finder should have been registered as a broker and that Ranieri and its former executive knew or should have known that the finder’s activities went beyond the scope of what the finder had been engaged to do. Ranieri Partners agreed to pay a penalty of \$375,000 and the former Ranieri executive agreed to pay a penalty of \$75,000 and observe a nine-month suspension from acting in a supervisory capacity at an investment adviser or a broker-dealer. See [In re Ranieri Partners LLC and Donald W. Phillips](#). The individual finder agreed to be barred from the securities industry. See [In re William M. Stephens](#).

used in connection with offerings for issuers that are not required to file reports under Section 13 or Section 15(d) of the Exchange Act. Persons who are associated persons of a broker-dealer and persons who are subject to a statutory disqualification as defined in Section 3(a)(39) of the Exchange Act would not be permitted to rely on the exemption. The arrangement between the finder and the issuer would have to be in writing and contain certain prescribed information.

If adopted as proposed, the exemption would provide that the finder may actively solicit investors for multiple offerings by:

- identifying, screening, and contacting potential investors;
- distributing issuer offering materials to investors;
- discussing issuer information included in any offering materials, provided that the finder may not give advice as to the valuation or advisability of the investment; and
- arranging or participating in meetings with the issuer and the prospective investor.

However, the following conditions would apply to the finder and his or her activities:

- The finder may not engage in a general solicitation;
- Investors solicited by the finder must be accredited investors (or reasonably believed by the finder to be accredited investors);
- The finder's activities would be restricted such that the finder could not:
 - participate in the preparation of any sales materials;
 - be involved in structuring the transaction or negotiating the terms of the offering;
 - provide advice as to the valuation or financial advisability of the investment;
 - perform any independent analysis of the transaction;
 - engage in any due diligence activities;
 - handle customer funds or securities;
 - have the ability to bind the investor or the issuer; or
 - assist with obtaining or providing financing for the transaction.

As noted above, the proposed exemption may be helpful to private fund managers that want to hire unregistered finders to source investors for their funds, as well as to operating companies that may not have access to financing through traditional venture capital and "angel investor" networks. Issuers may not be reporting companies, and the securities may not be publicly offered. The proposed exemption would not appear to benefit most registered funds, whose offerings typically are not exempt from registration under the Securities Act and are not limited to accredited investors. Moreover, the proposed exemption could not be used to facilitate a resale of securities. Finally, the proposed exemption also would not provide a useful alternative to private fund managers that wish to establish an affiliated broker-dealer, as the finder is

not permitted to perform certain critical functions that these broker-dealers perform, including preparing sales materials, structuring transactions, and/or advising on valuation and advisability of an investment.

Comments on the proposed exemption should be received by the Commission no later than November 12, 2020.

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For further information about how the issues described in this Alert may impact your interests, please contact [Brynn Rail](#) or your regular Ropes & Gray attorney.