

SEC Proposed Order Exempts Certain Finders From Registering as Broker

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On October 7, 2020, the Securities and Exchange Commission (the “SEC”) issued a Proposed Order (“Proposal”) to establish exemptions from the broker registration requirements for certain Finder activities (the “Proposal”).

If adopted, the Proposal will create two types of exempt Finders, Tier I Finders, and Tier II Finders. Each class of Finders would be subject to specified limitations on their respective activities. Both types of Finders would be permitted to accept transaction-based compensation under the Proposal.

Tier I Finders

A Tier I Finder may provide contact information of potential investors for only one capital raising transaction by one issuer in a 12-month period. Tier I Finders are not permitted to have any contact with potential investors concerning the issuer of the capital raising transaction or its securities.

Tier II Finders

Tier II Finders can solicit investors on behalf of an issuer; however as written, the Proposal would limit such solicitation activities to:

- Identifying, screening, and contacting potential investors;
- Distributing issuer offering materials to investors;
- 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
- Arranging or participating in meeting with the issuer and investor.

The Proposal also would establish several conditions applicable to both Tier I and Tier II Finders and other conditions applicable only to Tier II Finders.

Conditions for Both Tier I and Tier II Finders

- The issuer may not be a public, reporting company (or a company making an initial public offering);
- The offering must be a primary offering because the safe harbor is not available for resales of securities;

- The issuer's offering must be conducted in reliance on an applicable exemption from registration under the United States Securities Act of 1933;
- The Finder may not make a general solicitation, so that only prospective investors already know the Finder should be solicited;
- Prospective investors must be accredited investors or the Finder must have a reasonable belief that the potential investor is an accredited investor;
- The Finder may not be an associated person of a broker-dealer;
- The Finder may not be subject to statutory disqualification at the time that he or she engages in the activity; and
- There must be a written agreement between the Finder and the issuer including a description of the services the Finder will provide and specifying the compensation.

Conditions Solely Applicable to Tier II Finders

Tier II Finders must also meet all of the conditions below:

- Provide prior to or at the time of the solicitation, a disclosure that includes:
- The name of the Finder;
- The name of the issuer;
- A statement describing the terms of the compensation arrangement under which the Finder will be paid; A description of any relationship between the Finder and the issuer;
- An explanation of any material conflicts of interest arising from the arrangement or relationship between the Finder and the issuer;
- An affirmative statement that the Finder is acting as an agent of the issuer, is not acting as an associated person of a broker-dealer, and is not under any obligation to act in the investor's best interest; and
- Obtain from the investor, prior to or at the time of any investment in the issuer's securities, a dated, written acknowledgment of receipt of the above required disclosures.

If the required disclosures are made orally, the disclosures must again be made in writing no later than the time of any resulting investment in the issuer's securities.

Unregistered, exempt Finders may not:

- Obligate the issuer or investor;
- Assist in structuring transactions or negotiating the terms of an offering;
- Perform any due diligence activities;
- Receive or hold customer funds or securities;
- Assist in preparing any sales materials;
- Perform any independent analysis of the sale;
- Assist in obtaining or provide financing for such purchases;
- Provide investment advice such as the valuation or financial advisability of the investment; or
- Make any recommendation concerning the investment.

If approved by the SEC, the Proposal would establish what is known as a "safe harbor" for those

complying with its conditions. Under the “safe harbor” natural persons who comply with the conditions of the exemption are permitted to engage in the specified activities on behalf of issuers. They will not be held in violation of law for failing to register as brokers with the Commission if they fulfill all requirements of the exemption. A failure to meet the requisite conditions doesn’t necessarily constitute a violation of law. Nevertheless, given the SEC’s well-known concern about Finders, that outside of the “safe harbor” will face a heavy burden to persuade the SEC they are not acting as a broker.

Finders relying on the “safe harbor” should retain sufficient documentation to demonstrate compliance with the safe harbor’s conditions, including copies of the required disclosures and confirmation of its delivery.

A copy of the Proposal may be accessed [here](#). The SEC has solicited a number of questions so the conditions of the Proposal may change before adoption. The Lippes Mathias Securities Practice Team will provide further guidance when the SEC issues its order adopting the Proposal in its final form.

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