

## SEC Proposes Broker-Dealer Registration Relief for Certain Finders

21 October 2020

On October 7, 2020, the SEC issued a proposed order<sup>1</sup> that would, if adopted, exempt from broker-dealer registration requirements under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), certain compensated “finders” of investors for private issuers. The proposed order demonstrates the SEC’s continued focus on increasing private issuers’ access to capital and would significantly relax the SEC’s current view of unregistered finders in fundraising for private issuers (e.g., private companies and private funds).<sup>2</sup>

*Types of Eligible Finders.* The proposed order would create two tiers of exempt compensated finders, who would have different levels of restrictions on their activities:

- A “Tier I Finder” would be limited to providing potential investor contact information in connection with only a single capital raising transaction by a single private issuer in a 12-month period, without any direct contact between the finder and potential investors about the issuer.
- A “Tier II Finder” would be limited to: (i) identifying, screening and contacting potential investors; (ii) distributing private issuer offering materials to investors; (iii) discussing issuer information included in any offering materials; and (iv) arranging or participating in meetings with the issuer and investor. Tier II Finders would also be subject to detailed disclosure requirements about the finder arrangement to potential investors.<sup>3</sup>

The relief would only be available to natural persons, and any deviation from the above activities would require compliance with a different exemption, or else registration as or association with a registered broker-dealer.

*Conditions for Finder Exemption:* The proposed order would also impose the following conditions on finders in either tier:

- the issuer is not a public company, i.e., a company required to file reports under Section 13 or Section 15(d) of the Exchange Act (and accordingly, the issuer must have no registered securities outstanding, including debt securities);
- the issuer is seeking to conduct the securities offering in reliance on an applicable exemption from registration under the Securities Act of 1933, as amended (the “Securities Act”), such as Regulation D;
- the finder does not engage in general solicitation;
- each potential investor is, or the finder has a reasonable belief that the potential investor is, an “accredited investor”;
- 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 registered broker-dealer; and
- the finder is not subject to statutory disqualification under the Exchange Act, at the time of his or her participation.<sup>4</sup>

*Impermissible Activities for Exempt Finders.* The proposed order particularly noted that any finder involved in the following activities would not be eligible for exemptive relief: (i) structuring the transaction or negotiating the terms of the offering; (ii) handling customer funds or securities or binding the issuer or any investor; (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 purchases; or (vii) providing advice as to the valuation or financial advisability of the investment.

*Implications for Finder Exemption.* If adopted as proposed, this exemption would allow issuers such as private companies or private funds to engage natural persons who are not registered as or associated with a registered broker-dealer to assist with fundraising, and to pay such persons transaction-based compensation, including success fees. However, the proposed relief is limited to broker-dealer registration obligations under the Exchange Act and only applies to primary securities offerings and not registered offerings (e.g., IPOs) or secondary sales. Other restrictions at the state or investor level (such as state broker-dealer laws, pay-to-play rules and pension plan regulations) will continue to apply, and will need to be evaluated on a case-by-case basis.<sup>5</sup> As the proposed relief relates to finders retained by an issuer, it may have limited utility in the context of private equity firms wishing to hire finders to locate prospective portfolio companies.<sup>6</sup> Similarly, since the proposed exemption prohibits finders from being involved in the preparation of sales materials or having

the power to bind the issuer, it may be of limited use to compensate employees of private fund sponsors for sales of fund interests. The SEC will solicit comments to the proposed order for a period of 30 days after its publication in the Federal Register.

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1. <https://www.sec.gov/rules/exorders/2020/34-90112.pdf>. The SEC's educational resources relating to the proposed exemption, including an introductory video and summary chart, can be found on the [SEC's website](#).↵

2. The SEC staff previously issued a no-action letter allowing for certain M&A activity for control transactions in private companies without broker-dealer registration. See *KirklandPEN*: "[SEC Issues Broker-Dealer Registration Relief for Private M&A Brokers](#)" (March 12, 2014). For additional information on the SEC's previous focus in the area, see *KirklandPEN*: "[SEC Increases Focus on Transaction Fees and Other Broker-Dealer Issues for Private Fund Sponsors](#)" (April 15, 2013). Previous articles have highlighted SEC actions related to unregistered broker-dealers, including *KirklandPEN*: "[Private Fund Manager Settles SEC Enforcement Case for Acting as Unregistered Broker](#)" (June 3, 2016).↵

3. These disclosure requirements include: (i) the name of the finder and issuer; (ii) a description of the relationship between the finder and issuer, including any affiliation; (iii) a statement that the finder will be compensated for his or her solicitation activities by the issuer and a description of the terms of the compensation arrangement; (iv) any material conflicts of interest resulting from the arrangement or relationship between the finder and the issuer; and (v) the fact 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 undertaking a role to act in the investor's best interest. The proposed order provides that this disclosure may be made verbally, if it is supplemented with written disclosure, through paper or electronic means, prior to the investment itself. To qualify for registration relief, Tier II Finders must also obtain a dated written acknowledgement of disclosure receipt from the investor prior to the investment.↵

4. A person is subject to statutory disqualification under Section 3(a)(39) of the Exchange Act, if, among other things, he or she has been expelled or suspended from a self-regulatory organization or foreign or international securities exchange, subject to an order barring such person from being associated with a broker or dealer, associated with someone who is known or should have been known to have been any of the foregoing, or convicted of a felony involving (i) the purchase or sale of a security, perjury, bribery or any substantially equivalent activity, (ii) the conduct of a broker or dealer or (iii) larceny, theft, robbery, extortion, counterfeiting, embezzlement, misappropriation of funds or substantially equivalent activity.↵

5. For example, New York, California and Texas each have proposed or existing regulations relating to finder activity.↵

6. For these situations, private companies and finders will need to continue to rely upon, if applicable, previous no-action relief, or else register. For more information, see *KirklandPEN*: "[SEC Issues Broker-Dealer Registration Relief for Private M&A Brokers](#)" (March 12, 2014).↵

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## Suggested Reading

- 17 November 2020 Kirkland Seminar Evolving Convertible Bond Strategies for Corporates
- 04 November 2020 & 05 November 2020 Kirkland Seminar Kirkland Liquidity Solutions Academy

- 03 November 2020 Speaking Engagement International Bar Association's Virtual Conference

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