

Investment Management Alert

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SEC Proposes Exempting Finders, Subject to Compliance Obligations

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On October 9, 2020, the Securities and Exchange Commission (SEC) proposed an order that would exempt from registration as broker-dealers certain natural person “finders” who help locate investors in connection with the sale of securities of private issuers in exempt primary offerings to accredited investors (the “Proposed Finders Order”).¹ The Proposed Finders Order would require all finders to satisfy certain conditions and would further divide finders into two categories—(i) “Tier I Finders,” who engage in only one solicitation per 12-month period and whose activity is limited to providing contact information to a single issuer without contacting potential investors, and (ii) “Tier II Finders,” who may conduct certain limited solicitation activities beyond those of Tier I Finders but must disclose the relationship and arrangement with the issuer and must receive an acknowledgement from the investor.

To qualify as a “finder,” the natural person must:

- Not be an associated person of a broker-dealer and not be subject to a statutory disqualification.
- Only solicit potential investors that the natural person has a reasonable belief are accredited investors.
- Not engage in general solicitation.
- Only offer securities in a primary offering in an offering that is exempt from registration under the Securities Act of 1933, as amended, for issuers that are not required to file reports under the Securities Exchange Act of 1934, as amended (the “Exchange Act”).
- Enter into a written agreement with the issuer that includes a description of the services that are to be provided and the associated compensation.

Tier I

A Tier I Finder is limited to finders who engage in only one solicitation per 12-month period and whose activity is limited to providing contact information to a single issuer without contacting potential investors. These limitations on Tier I Finders are similar to those previously discussed in no-action letters from the SEC staff, but the Proposed Finders Order would permit Tier I Finders to receive transaction-based compensation.

Contact Information

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Tier II

Tier II Finders are not subject to the one solicitation per year restriction applicable to Tier I Finders and are able to enter into broader solicitation activities, subject to additional disclosure requirements. Tier II Finders are limited² to the following solicitation activities without being required to register as a broker-dealer:

- Identification, screening and contacting potential investors.
- Distributing issuer offering materials to investors.
- Discussing issuer information in offering materials, so long as the Tier II Finder does not provide advice as to the valuation or advisability of the investment.
- Arranging or participating in meetings with the issuer and the investor.

A Tier II Finder would be required to provide disclosure to potential investors prior to or at the time of the solicitation³ of the following:

- The name of the Tier II Finder.
- The name of the relevant issuer.
- A description of the relationship and affiliation between the Tier II Finder and the issuer.
- A statement that the Tier II Finder will be compensated for the solicitation activities by the issuer and a description of the terms of the compensation.
- Any material conflicts of interest resulting from the arrangement or relationship with the issuer.
- An affirmative statement that the Tier II Finder is acting as an agent of the issuer, is not acting as an associated person of the a broker-dealer and is not undertaking to act in the investor's best interest.

The investor must obtain a dated written acknowledgement of the Tier II Finder's disclosures prior to the time of the investment. This acknowledgement may be received through paper or electronic means.

Conclusion

The Proposed Finders Order would be a safe harbor from the registration requirements of the Exchange Act, but the SEC does not intend the Proposed Finders Order to create the presumption that a person that does not satisfy its conditions is engaged in the business of being a broker that register with the SEC. If adopted, it remains unclear how this Proposed Finders Order would interact with broker-dealer requirements at the state level.⁴

The SEC staff also published a chart, which summarizes the permitted and prohibited activities under the Proposed Finders Order.⁵

¹ See Release 34-90112 (Oct. 7, 2020) available at <https://www.sec.gov/rules/exorders/2020/34-90112.pdf>.

² In addition to the restrictions for Finders limited above, Tier II Finder would be specifically prohibited from (i) handling customer funds or securities, (ii) binding the issuer or investor, (iii) participating in the preparation of offering materials, (iv) performing any independent analysis of the sale, (v) engaging in any due diligence activities, (vi) assisting or providing financing for the purchases or (vii) providing advice as to the valuation or

financial advisability of the investment. A Tier II Finder also could not structure or negotiate the terms of the offering.

³ The disclosure may be made orally, so long as it is followed by written disclosure satisfying all of the below no later than the time of investment.

⁴ It is ambiguous whether the SEC intends for the proposed order to re-define the term broker to exclude “finders” or if it only intends to exempt from the registration requirement of the Securities Exchange Act of 1934, as amended. We note that some states, such as Texas have their own finder registration regimes.

⁵ The chart is available at <https://www.sec.gov/files/overview-chart-of-finders.pdf>.

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