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SEC Advisory Committee Recommendations Related To Finders

The following is written by Laura Anthony, Esq., a going public attorney focused on OTC listing requirements, direct public offerings, going public transactions, reverse mergers, Form 10 and Form S-1 registration statements, SEC compliance and OTC Market reporting requirements.

On September 23, 2015, the SEC Advisory Committee on Small and Emerging Companies (the “Advisory Committee”) met and finalized its recommendation to the SEC regarding the regulation of finders and other intermediaries in small business capital formation transactions. This is a topic I have written about often, including a recent comprehensive blog which can be read [HERE](#).

By way of reminder, the Committee was organized by the SEC to provide advice on SEC rules, regulations and policies regarding “its mission of protecting investors, maintaining fair, orderly and efficient markets and facilitating capital formation” as related to “(i) capital raising by emerging privately held small businesses and publicly traded companies with less than \$250 million in public market capitalization; (ii) trading in the securities of such businesses and companies; and (iii) public reporting and corporate governance requirements to which such businesses and companies are subject.”

The Advisory Committee discussed the topic at its meetings on June 3, 2015 and again on July 15, 2015 before finalizing its recommendations, which were published on September 23, 2015. In formulating its recommendations, the Advisory Committee gave specific consideration to the following facts:

The Advisory Committee made four recommendations related to the regulation of finders and other intermediaries in small business capital formation transactions, which I support but have doubts as to the realistic implementation. In particular:

- (1) The SEC take steps to clarify the current ambiguity in broker-dealer regulation by determining that persons that receive transaction-based compensation solely for providing names of or introductions to prospective investors are not subject to registration as a broker under the Exchange Act.
- (2) The SEC exempt intermediaries on a federal level that are actively involved in the discussions, negotiations and structuring, and solicitation of prospective investors for private financings as long as such intermediaries are registered on the state level.
- (3) The SEC spearhead a joint effort with the North American Securities Administrators Association (NASAA) and FINRA to ensure coordinated state regulation and adoption of measured regulation that is transparent, responsive to the needs of small businesses for capital, proportional to the risks to which investors in such offerings are exposed, and capable of early implementation and ongoing enforcement; and
- (4) The SEC should take immediate steps to begin to address this set of issues incrementally instead of waiting for the development of a comprehensive solution.

Advisory Committee Considerations in Support of Its Recommendations

The Advisory Committee Letter lists practical facts and realities related to small business and emerging company capital formation in support of its recommendations. In particular:

(1) Small businesses account for the creation of two-thirds of all new jobs, and are the incubators of innovation, generating the majority of net new jobs in the last five years and continuing to add more jobs;

(2) Early-stage capital for these small businesses is raised principally through private offerings that are exempt from registration under the Securities Act of 1933 and state blue sky laws;

(3) More than 95% of private offerings rely on Rule 506 of Regulation D; however, less than 15% of those use a financial intermediary such as a broker-dealer. This is due in part to a lack of interest from registered broker-dealers given the legal costs and risk involved in undertaking a small transaction, ambiguities in the definition of “broker” and the danger of using unregistered finders. (For more on the topic of incentives for broker-dealers to work with smaller offerings, see my blog [HERE](#)).

(4) As documented in the findings of an American Bar Association Business Law Section Task Force in 2005 and endorsed by the SEC Government Business Forum on Small Business Capital Formation: (i) failure to address the regulatory issues surrounding finders and other private placement intermediaries impedes capital formation for smaller companies; (ii) the current broker-dealer registration system and FINRA membership process is a deterrent to meaningful oversight; (iii) appropriate regulation would enhance economic growth and job creation; and (iv) solutions are achievable through SEC leadership and coordination with FINRA and the states. For more on the ABA Task Force study, see my blog [HERE](#).

(5) The Advisory Committee is of the view that imposing only limited regulatory requirements, including appropriate investor protections and safeguards on private placement intermediaries with limited activities that do not hold customer funds or securities and deal only with accredited investors, would enhance capital formation and promote job creation.

My Thoughts

I'm practically jumping up and down with excitement that the Advisory Committee gets the issues and is discussing the matter from an overarching theoretical top-down standpoint. To create a workable system, there first has to be a general mapping and understanding of the directional goals. However, my excitement turns realistic, and unfortunately pessimistic, at the thought of the states, FINRA and the NASAA working together to find and actually implement a comprehensive regulatory solution.

Despite the SEC support for the NASAA coordinated review program to simplify the state blue sky process for securities offerings, such as under Tier 1 of Regulation A+, only 43 states participate. I say "only" in this context because the holdouts – including, for example, Florida, New York, Arizona and Georgia – are extremely active states for small business development and private capital formation. Moreover, even using the coordinated review program, the states have vastly different rules and interpretations of the same rules. See my blog [HERE](#) for further discussion.

I simply am an advocate for federal over state regulation on securities law matters. Rather than requiring state registration, I would simply create a federal exemption to the broker-dealer registration requirements for finders provided that:

- (1) The offering was being made in reliance on an exemption from the Securities Act registration requirements which exemption also exempts state law under the NSMIA (such as Rule 506 of Regulation D or Tier 2 of Regulation A+);
- (2) All offers and sales are limited to accredited investors;
- (3) The finders do not hold customer funds or securities;
- (4) The issuers and finders have disclosure requirements related to the role of the finder and compensation being paid (similar to Section 17(b) disclosure requirements under the Securities Act); and
- (5) The finders have liability for violations of the anti-fraud provisions by the issuers to the same extent as underwriter liability.

Of course, issuers would remain subject to all of the current anti-fraud provisions of the private offering exemption laws and thus would be responsible for the representations and actions of their finders, as they are now. Allowing an “above the line” profession of finders to develop will naturally create an environment where those finders that engage in unscrupulous methods will be easily identified and avoided.

For a review of the NSMIA and state blue sky laws, see my two-part blog [HERE](#) and [HERE](#).

The Author

Attorney Laura Anthony
Founding Partner
Legal & Compliance, LLC
Corporate, Securities and Going Public Attorneys
LAnthony@LegalAndCompliance.com

Securities Law Blog is written by Laura Anthony, Esq., a going public lawyer focused on OTC Listing Requirements, Direct Public Offerings, Going Public Transactions, Reverse Mergers, Form 10 Registration Statements, and Form S-1 Registration Statements. Securities Law Blog covers topics ranging from SEC Compliance, FINRA Compliance, DTC Chills, Going Public on the OTC, and OTCQX and OTCQB Reporting Requirements. Ms. Anthony is also the host of LawCast.com, the securities law network.

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