



November 11, 2020

VIA INTERNET UPLOAD

Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

RE: File No: S7-13-20
Notice of Proposed Exemptive Order Granting Conditional Exemption from the Broker
Registration Requirements of Section 15(a) of the Securities Exchange Act of 1934 for Certain
Activities of Finders

Dear Ms. Countryman,

We are pleased that the U.S. Securities and Exchange Commission (“the Commission”) is advancing efforts to facilitate capital formation and providing clarity on broker-dealer registration requirements.¹ Please accept this comment regarding the proposed exemptive order (“the Proposal”) which would provide a safe harbor to certain persons (“Finders”) who introduce accredited investors to non-public companies in connection with a private placement of securities. As we will discuss in this letter, the Proposal is a groundbreaking change and offers many potential benefits. We appreciate the opportunity to contribute to this important conversation.

For perspective, MarketCounsel Consulting, LLC (“MarketCounsel”) is a business and regulatory compliance consulting firm to some of the country’s preeminent independent investment advisers. From its roots in 2000, MarketCounsel has been steadfast in its mission to deliver solutions to the most substantial challenges faced by entrepreneurs in this fast-growing and highly-regulated industry and it has emerged as one of its most effective advocates. In addition, our affiliated law firm, the Hamburger Law Firm, supports business endeavors in and around the securities industry, throughout their lifecycle. They counsel startup investment advisers, manage the employment transition for the industry’s most accomplished financial advisers, and represent established investment advisers, financial technology firms, broker-dealers, funds, and their corresponding service providers as they navigate a broad array of complex issues faced by growing companies in a highly-regulated space.

We write today in support of the Proposal while seeking additional clarity for the registration requirements for Finders. The Proposal will help clear up current uncertainties about the status of Finders since the current ambiguity presents legal risks and obstacles for private companies seeking to raise capital as well

¹ Notice of Proposed Exemptive Order Granting Conditional Exemption from the Broker Registration Requirements of Section 15(a) of the Securities Exchange Act of 1934 for Certain Activities of Finders, SEC Rel. No. 34-90112; 85 Fed. Reg. 64542, October 13, 2020) (<https://www.govinfo.gov/content/pkg/FR-2020-10-13/pdf/2020-22565.pdf>.) (“the Proposal”).

as intermediaries who could aid issuers and investors. However, we feel that that some of the limitations on the Proposal's narrowly tailored exemption will prevent it from being useful for the challenges faced by small issuers as well as limiting some important participants from taking advantage of the Finder definition. In particular, limiting the exemption to natural persons prevents Finders from using the advantages of a corporate entity. Also, we believe that registered investment advisers should be carved out of some of the prohibited activities of a Finder. This would allow issuers to utilize investment advisers as Finders while providing the fiduciary protections that protect investors. We write below to offer suggestions on how the Commission can improve the Proposal, so that Finders can better assist in the formation of capital and in providing investors with improved investment options.

HISTORICAL CONTEXT

Small businesses face daunting challenges when raising capital outside of the public markets. Private issuers that need to raise funds are frequently required to look beyond their immediate network. Too small for the public markets, private issuers turned to persons who could introduce them a wider pool of prospective investors. The activities of these persons would seem to fall outside the traditional scope of a broker-dealer's services. However, given broker-dealer registration requirements and the Commission's expansive reading of those requirements, the need for Finders to register as broker-dealers has remained unclear.²

Section 15(a)(1) of the Exchange Act of 1934 ("the Exchange Act") makes it unlawful for any person to induce or attempt to induce the purchase or sale of, any security (other than an exempted security or commercial paper, bankers' acceptances, or commercial bills) unless such a broker or dealer is registered.³ Section 3(4) of the Exchange Act defines "broker" broadly to mean "any person engaged in the business of effecting transactions in securities for the account of others."⁴

Whether a person falls under the definition of a broker often depends on the degree to which they are involved in a transaction. Since effecting a transaction has been interpreted to extend far beyond mere execution, this determination requires an individualized facts-and-circumstances analysis. Historically, merely identifying investors who may wish to participate in the transaction has often fallen under the broker definition because the Commission looks at persons who are involved at key points in the "chain of distribution."⁵ In addition to a person's involvement, the Commission has cited the receipt of transaction-based compensation as a strong indicator of person who meets the definition of a broker. Transaction-based compensation may include compensation for leads or even arranging meetings.⁶

Failing to register as broker-dealer when required gives rise to series of consequences which are, of course, designed to make unregistered activity unappealing. For example, failing to register when required can lead to enforcement actions from the Commission or state agencies against the individual or the issuer for failing to follow the registration requirements.⁷ In turn, those enforcement actions can create rescission claims by investors who were solicited by the unregistered broker. In addition to civil penalties and equitable relief, the Commission can also seek a permanent or temporary injunction or a restraining order against an unregistered broker-dealer as well as criminal proceedings.⁸ The lack of clarity for when a person must register, and the severity of the consequences for not registering, has created a large moat that has been harmful to capital formation activity.

² The Proposal at 64543

³ 15 U.S. Code § 78o(a)(1).

⁴ 15 U.S. Code § 78c (3)(4).

⁵ *Mass. Fin. Servs., Inc. v. Sec. Inv'r Prot. Corp.*, 411 F. Supp. 411, 415(D. Mass.)

⁶ *SEC v. Margolin*, 1992 U.S. Dist. LEXIS 14872 (S.D.N.Y. Sept. 30, 1992)

⁷ 15 USC §78cc(b)

⁸ 15 U.S. Code § 78u(d)(1).

The Commission has permitted some Finders to operate without registration through a limited series of no-action letters. For example, the Paul Anka no-action letter permitted a one-time exemption allowing Mr. Anka to provide a list of names and telephone numbers to help raise money for a limited partnership.⁹ However, the Commission has generally declined to provide no-action relief in instances where an individual's involvement extends to acting as a Finder on a regular basis and for activities beyond making introductions.¹⁰

SAFE HARBOR REQUIREMENTS

Sections 15(a)(2) and 36(a)(1) of the Exchange Act authorize the Commission to grant exemptions from broker-dealer requirements and any other provisions of the Exchange Act when the Commission determines the exemption is in the public interest.¹¹ The Proposal, issued pursuant to this authority, is narrowly tailored to permit only a limited set of activities but far wider than what is currently permitted. In issuing the exemption, the Commission states that it is seeking to balance capital formation and investor protection. We do not believe that the requirements go far enough to strike the right balance.

The Proposal creates two tiers of exempt Finders. While each tier would have different restrictions on their level of activities, both tiers are subject to the following restrictions: (i) the issuer is not a public company, (ii) the issuer is offering securities exempt from registration under the Securities Act of 1933, (iii) the Finder does not engage in general solicitation, (iv) the Finder provides services pursuant to a written agreement with the issuer, (v) the Finder is not an "associated person" of a broker-dealer, (vi) the Finder is not subject to a statutory disqualification under the Exchange Act, and (vii) each prospective investor is or reasonably believed to be an "accredited investor."¹²

Beyond sourcing potential investors, the Finder faces limitations from providing other services in connection with the private investment. A Finder may not engage in the following activities: (i) structure or negotiate terms of the investment; (ii) handle investor funds or bind any party; (iii) participate in the preparation of sales materials; (iv) provide, or assist in providing, financing for purchases; (v) offer independent analysis of the investment; (vi) engage in any "due diligence; or (vii) give advice about the valuation or quality of the investment.¹³

Tier I status extends the Paul Anka no-action relief from a onetime activity to an annual frequency. Tier I Finders are 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.

Tier II Finders are not subject to single issuer or annual frequency limitations. Tier II Finders can: (i) identify, screen and contact potential investors; (ii) distribute private issuer offering materials to investors; (iii) discuss issuer information included in any offering materials; and (iv) arrange or participate in meetings with the issuer and investor.¹⁴

The Proposal permits Tier II Finders to engage in activities that the Commission considers solicitation (any affirmative efforts to induce or attempt to induce a securities transaction).¹⁵ Since solicitation has traditionally been cited by the SEC staff as a key factor supporting the application of the Exchange Act's broker-dealer registration requirement, Tier II represents a significant advancement in loosening the Exchange Act's registration requirements.

⁹ Paul Anka, SEC no-action letter (July 24, 1991)

¹⁰ John W. Loofbourrow Associates, Inc., SEC no action letter (June 29, 2006) and Brumberg, Mackey & Wall, P.L.C., SEC no action letter (May 17, 2010)

¹¹ 15 U.S. Code § 78o & 15 U.S. Code § 78mm

¹² The Proposal at 64546

¹³ The Proposal at 64548

¹⁴ *Ibid.*

¹⁵ Rule 15a-6 Adopting Release at 54 FR 30017-30018

Given their solicitation activities, Tier II Finders must follow additional detailed disclosure requirements. Tier II Finders must provide each investor with disclosures that include: (i) the name of the Finder; (ii) the name of the issuer; (iii) a description of the relationship between the Finder and the issuer, including any affiliations; (iv) a statement that Finder will be compensated by the issue and the terms of that compensation; (v) disclosure of material conflicts of interest between the Finder and the issuer; and (vi) a statement that the Finder is acting as an agent of the issuer and not as an associated person of a broker-dealer or undertaking any requirement to act in the investor's best interest.¹⁶

We believe that the Proposal will be beneficial to private issuers. However, some of the proposed limitations are unnecessary and will limit the potential relief that was intended.

INCLUDE CORPORATE PERSONS

The Proposal's requirement that the Finder be a natural person prevents Finders from taking advantage of modern business entities. First, Finders would be able to put in place the general liability protections that the corporate form offers. Few financial professionals today operate as sole proprietors. Most independent professionals choose to conduct their business through a corporate or unincorporated business association (most often, a limited liability company), which provides personal liability protections from lawful business activities. The Proposal should allow Finders to separate legal entities.

In addition, allowing Finders to act through business entities would result in superior Finders. Such Finders could structure sound businesses including economic relationships, training, and supervision of its staff. This would benefit Finders, but also issuers and investors.

Previous studies on the role of Finders provide a basis for including corporate entities in the Proposal's safe harbor. In support of the Proposal, Commissioner Roisman and Chairman Clayton cited previous studies dating back to 2005.¹⁷ The first study they cited, the *American Bar Association's Report and Recommendations of the Task Force on Private Placement Broker-Dealers*, recommended a simplified system of broker-dealer registration for private placement broker-dealers which recognizes that broker-dealers would use a corporate form.¹⁸ Similarly, the Commission's Advisory Committee on Small and Emerging Companies recommendations on the regulation of finders called on the Commission 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 Securities Exchange Act."¹⁹ There was nothing in those recommendations that limited activities to "natural persons." In fact, we do not believe that any of the studies cited called for a limitation to natural persons.

Until this proposal, the Commission has not provided a definition of the term Finder. Yet other regulators have previously provided a definition, some of which extend the term Finder beyond a natural person. The State of Michigan was the first state to offer a Finder exemption. The Michigan statute defines a finder as, "a person who, for consideration, participates in the offer to sell, sale or purchase of securities by locating, introducing or referring potential purchasers or sellers."²⁰ Under the Michigan statute, business entities are considered persons. FINRA also provides a limited Finders exemption. FINRA's rule 2040 offers a foreign finder's exemption, which specifically extends to foreign entities domiciled abroad. Conversely, the California Department of Financial Protection and Innovation is one regulator that limits its Finder

¹⁶ The Proposal at 64548

¹⁷ Open Meeting on Proposed Finders Exemption – Providing Regulatory Clarity to Benefit Small Businesses.

<https://www.sec.gov/news/public-statement/clayton-proposed-finders-exemption-2020-10-07>

¹⁸ Report and commendations of the American Bar Association Business Law Section Task Force on Private Placement Broker-Dealers, sec.gov, June 2005, <https://www.sec.gov/info/smallbus/2009gbforum/abareport062005.pdf>

<https://www.sec.gov/info/smallbus/2009gbforum/abareport062005.pdf>

¹⁹ SEC Advisory Committee on Small and Emerging Companies. Sec.gov. <https://www.sec.gov/info/smallbus/acsec/acsec-recommendations-regulation-of-finders.pdf>

²⁰ MCL 451.2102

exemption to natural persons.²¹ There is little evidence that this exemption is widely used, in part because of the natural person requirement.²²

Given the liability protections of a separate legal entity, formal business structure, previous studies cited by the Commission, and the experience of other regulators, we respectfully submit that the Commission should extend the Proposal's exemption beyond natural persons.

PROVIDE CLARITY FOR INVESTMENT ADVISERS

Perhaps the biggest miss of the proposal is the omission of registered investment advisers. The objectives of the proposal would be accelerated by explicitly permitting registered investment advisers to qualify as Finders. Investment advisers often provide their clients with fiduciary advice about private securities. Many of these investments have a long-time horizon which makes it impractical to charge an ongoing advisory fee. In those situations, it would be in the best interest of accredited investors to receive fiduciary advice from an investment adviser that is compensated as a Finder by the issuer.

Certain of the Proposal's limitations would prohibit an investment adviser from providing its services while acting as a Finder. An important part of an investment adviser's advice to its clients when recommending private investments would almost certainly include offering independent analysis of the investment, engaging in due diligence, and giving advice about the valuation and quality of the investment. It would be beneficial to accredited investors and issuers alike to allow investment advisers to provide their fiduciary services while qualifying as a Finder. This would result in superior protections and better pricing for investors as well as access to more capital for issuers by capturing the asset base of registered investment advisers within the rule's purview.

We believe that investment adviser regulations and disclosures are well-positioned for a Finder's exemption. Investment advisers must already disclose their compensation arrangements throughout Form ADV.²³ The instructions to Part 2 notify investment advisers that they should consider broker-dealer registration requirements if they receive transaction compensation for securities sales.²⁴ Even the Proposal seemed to anticipate that investment advisers would be Finders when the Commission warned Finders that the broker-dealer exemption "does not insulate a person from the registration requirements of the Advisers Act if such person is acting as an investment adviser."²⁵

While investment advisers may be able to carefully disclose that with respect to their activities as Finders they are not providing clients with an independent analysis of the investment, engaging in any due diligence, or giving advice about the valuation or quality of the investment in order to comply with the Tier II restrictions, that limitation doesn't seem to benefit investors. Therefore, we ask that that the Commission exempt investment advisers from the restrictions so that they can provide their fiduciary advice while qualifying as a Finder.

²¹ 2040. Payments to Unregistered Persons | FINRA.org. <https://www.finra.org/rules-guidance/rulebooks/finra-rules/2040>

²² California Finder Exemption of Little Help, San Diego County Bar Association. <https://www.sdcba.org/?pg=BusinessandCorporate201709>

²³ See *ADV Part 1, Item 5.E; ADV Part 2A Items 5, 10, and 14; ADV Part 2B Item 5; and Form CRS Item 3*. Form ADV General Instructions, sec.gov. <https://www.sec.gov/about/forms/formadv-instructions.pdf>; General Instructions for Part 2 of Form ADV. sec.gov <https://www.sec.gov/about/forms/formadv-part2.pdf>; Form CRS Appendix B, sec.gov <https://www.sec.gov/rules/final/2019/34-86032-appendix-b.pdf>.

²⁴ "If you receive compensation in connection with the purchase or sale of securities, you should carefully consider the applicability of the broker-dealer registration requirements of the Securities Exchange Act of 1934 and any applicable state securities statutes." General Instructions for Part 2 of Form ADV. sec.gov. <https://www.sec.gov/about/forms/formadv-part2.pdf>;

²⁵ The Proposal at 64550.

CONSIDER STREAMLINED REGISTRATION

The Proposal is designed to act as a safe harbor. While the Proposal provides relief from registration as a broker-dealer with the Commission, other requirements such as state broker-dealer laws, pay-to-play rules and pension plan regulations would still apply to Finders. Considering the activities permitted by the safe harbor, it is likely that most Finders would still have to register as broker-dealers in the states where they conduct business. Since the adoption of parallel state Finders exemptions is unlikely, Finders would be left to navigate the patchwork of state broker-dealer exemptions and requirements.

The Commission could address the problem of state regulation by requiring a streamlined registration of Finders under the Exchange Act. As SEC registrants, Finders would be exempt from state broker-dealer registration requirements. A simplified system of broker-dealer registration for private placement broker-dealers is what the ABA Study, cited by the Commission in its Proposal, had recommended. A study by the U.S. Treasury Department also recommends placing Finders into a new regulatory structure, which is something more robust than the Proposal's safe harbor.²⁶ In addition, simplified registration would provide the Commission insight into the Finders market and alleviate some of the concerns specifically raised by Commissioner Lee who stated that she would support a scaled registration format.²⁷

CONCLUSION

MarketCounsel strongly supports adding clarity to the broker-dealer registration requirements for Finders of private securities. Exempting Finders from traditional broker-dealer registration would ensure more access to capital for small companies and private funds. The narrowly tailored restrictions on activities, required disclosures, and limited scope of issuers and investors all ensure investor protection.

To make the Proposal's exemption more effective, we suggest that the Commission consider the following three changes. First, extend the Proposal's exemption to apply beyond natural persons, to business entities. Second, provide express relief to registered investment advisers so that they can serve their clients' best interests. Third, allow for a streamlined Finder registration to provide clarity into the Finder market and exempt Finders from state broker-dealer registration requirements.

We hope that our comments made on behalf of us, and our independent investment adviser clients, who serve investors across the country, are beneficial to this process. Should you have any questions or require any additional information regarding any of the foregoing, we remain available at your convenience using any of the methods below.

Best regards,
MARKETCOUNSEL CONSULTING, LLC

By:



Brian Hamburger, JD, CRCP
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Chief Regulatory Counsel

²⁶ Treasury Department, A Financial System That Creates Economic Opportunities Capital Markets (October 2017), available at <https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-Capital-Markets-FINAL-FINAL.pdf>.

²⁷ Regulating in the Dark: What We Don't Know About Finders Can Hurt Us. Lee, Allison. Sec.gov. <https://www.sec.gov/news/public-statement/lee-proposed-finders-exemption-2020-10-07> "I could have supported a rulemaking process that proposed a scaled registration format that required, at a minimum, some form of record keeping and examination authority."