

*Presenting a live 90-minute webinar with interactive Q&A*

## **Finders and Unregistered Broker-Dealers: Risks and Recent Developments**

Pitfalls of Broker-Dealer Registration Violations, Recent SEC  
Enforcement Actions and FINRA Guidance

---

THURSDAY, NOVEMBER 9, 2017

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

---

Today's faculty features:

**Parker B. Morrill, Clyde Snow & Sessions, Salt Lake City**

**Arina Shulga, Ross & Shulga PLLC, New York**

---

The audio portion of the conference may be accessed via the telephone or by using your computer's speakers. Please refer to the instructions emailed to registrants for additional information. If you have any questions, please contact **Customer Service at 1-800-926-7926 ext. 10.**

## *Tips for Optimal Quality*

FOR LIVE EVENT ONLY

---

### Sound Quality

If you are listening via your computer speakers, please note that the quality of your sound will vary depending on the speed and quality of your internet connection.

If the sound quality is not satisfactory, you may listen via the phone: dial **1-866-961-8499** and enter your PIN when prompted. Otherwise, please **send us a chat** or e-mail [sound@straffordpub.com](mailto:sound@straffordpub.com) immediately so we can address the problem.

If you dialed in and have any difficulties during the call, press \*0 for assistance.

### Viewing Quality

To maximize your screen, press the F11 key on your keyboard. To exit full screen, press the F11 key again.

## *Continuing Education Credits*

FOR LIVE EVENT ONLY

---

In order for us to process your continuing education credit, you must confirm your participation in this webinar by completing and submitting the Attendance Affirmation/Evaluation after the webinar.

A link to the Attendance Affirmation/Evaluation will be in the thank you email that you will receive immediately following the program.

For additional information about continuing education, call us at 1-800-926-7926 ext. 35.

## *Program Materials*

FOR LIVE EVENT ONLY

---

If you have not printed the conference materials for this program, please complete the following steps:

- Click on the ^ symbol next to “Conference Materials” in the middle of the left-hand column on your screen.
- Click on the tab labeled “Handouts” that appears, and there you will see a PDF of the slides for today's program.
- Double click on the PDF and a separate page will open.
- Print the slides by clicking on the printer icon.

# Finders and Unregistered Broker-Dealers: Understanding the Risks and Recent Developments

November 9, 2017

---

**Parker B. Morrill**

Associate

Clyde Snow & Sessions  
201 South Main Street, Suite 1300  
Salt Lake City, Utah 84111

T (801) 322-2516

F (801) 521-6280

E [pbm@clydesnow.com](mailto:pbm@clydesnow.com)

W [www.clydesnow.com](http://www.clydesnow.com)



**Arina Shulga**

Partner

Ross & Shulga PLLC  
75 Maiden Lane, Suite 903  
New York, NY 10038

T (212) 379-6755

F (646) 453-7669

E [arina@Rsglobal.law](mailto:arina@Rsglobal.law)

W [www.Rsglobal.law](http://www.Rsglobal.law)



# Finders and Unregistered Broker-Dealers: Understanding the Risks and Recent Developments

## Program Outline

- I. Federal Securities Laws Applicable to Activities of Unregistered Broker-Dealers
- II. Risks, Penalties and Enforcement Actions
- III. Determining Whether a Finder is an Unregistered Broker-Dealer
- IV. SEC and FINRA Regulatory Guidance
- V. Exemptions
- VI. SEC OCIE Examination of Broker-Dealer Issues in Private Investment Funds
- VII. Other Developments

# Federal Securities Laws Applicable to Activities of Unregistered Broker-Dealers

# Federal Securities Laws

- Securities Exchange Act of 1934
  - A broker is defined as “any person engaged in the business of effecting transactions in securities for the accounts of others.”
  - The federal securities laws have no formal definition of a finder.
  - It is unlawful to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security unless registered as a broker or dealer.



# Broker-Dealer Registration

- Form BD
- Register with the SEC
- Register with FINRA
- Register with the States
  - No registration pre-emption
  - Exemptions vary by state

# SEC Broker-Dealer Guide – Questions to Ask

- Do you participate in important parts of a securities transaction, including solicitation, negotiation, or execution of the transaction?
- Does your compensation for participation in the transaction depend upon, or is it related to, the outcome or size of the transaction or deal? Do you receive trailing commissions, such as 12b-1 fees? Do you receive any other transaction-related compensation?
- Are you otherwise engaged in the business of effecting or facilitating securities transactions?
- Do you handle the securities or funds of others in connection with securities transactions?

# Risks, Penalties and Enforcement Actions

## II. Risks, Penalties and Enforcement Actions

### A. Risks and Penalties

1. SEC Enforcement
2. State Enforcement
3. Controlling Person and Aider and Abettor Liability
4. Right of Rescission
5. Bad Actor Disqualification under Rule 506(d)
6. How can the SEC find out about a finder acting as an unregistered broker?

### B. Recent Enforcement Actions

1. Wrongful Conduct Plus B-D Registration Violation
2. In the Matter of Ranieri Partners LLC
3. In the Matter of Blackstreet Capital Management, LLC
4. Lawyers Offered EB-5 Investments as Unregistered Brokers

## A. Risks and Penalties

### 1. SEC Enforcement

- Investigative authority and subpoena power
- Administrative cease-and-desist proceedings
  - Accounting and disgorgement
  - Civil money penalty
    - \$5,000 to \$100,000 natural persons
    - \$50,000 to \$500,000 other persons
- Federal court action
  - Injunction
  - Civil money penalties
- Criminal for willful violations

## 2. State Enforcement

- States may bring similar enforcement actions for violations of state broker-dealer registration requirements

### 3. Secondary Liability

- Controlling Persons
  - Person who controls person liable is jointly and severally liable unless controlling person acted in good faith and did induce the violation
- Aider and Abettor
  - Person who knowingly or recklessly provides substantial assistance to violator is deemed a violator

#### 4. Right of Rescission

- Contracts in violation of broker-dealer registration requirements are void as to violator
- Investor can rescind purchase of security from issuer, unregistered broker cannot collect fee



## 5. Bad Actor Disqualification Under Rule 506(d)

- Offering disqualified from relying on Rule 506 exemption in Regulation D if issuer or other person covered by rule has securities-related criminal conviction, regulatory or court order, or other disqualifying event that occurred on or after September 23, 2013.
- Persons covered – issuer; directors, general partners, managing members, executive or participating officers; 20% beneficial owners; investment managers of pooled investment funds and their principals; compensated solicitors.

6. How can the SEC find out about a finder acting as an unregistered broker?
- Form D disclosure – Items 12 and 15 of Form D require disclosure of sales commissions and “finders’ fees”
  - Tips from disgruntled investors or competitors of issuer or finder
  - Routine examinations

# Recent Enforcement Actions

- Unlawful Conduct Plus Broker-Dealer Registration Violation
  - SEC enforcement actions for violations of registration requirements have overwhelmingly involved fraudulent, deceptive or illegal conduct in addition to registration failure
  - Recent enforcement actions show SEC will pursue failure to register as B-D in situations not involving fraud

# In the Matter of Ranieri Partners LLC et al., Exchange Act Release No. 69091 (March 8, 2013)

- SEC administrative cease-and-desist proceeding against private fund adviser and senior managing partner for violation of broker-dealer registration requirements
- Fund paid transaction-based compensation (1% of capital commitments) to unregistered consultant for actively soliciting investors
- Consultant: (1) sent offering materials to prospective investors, (2) urged investor to adjust portfolio allocation to accommodate investment, (3) provided investors with analysis of firm's funds' strategy and track record, and (4) provided investors with confidential information about identity and capital commitments of other investors
- Firm fined \$375,000 and senior managing partner \$75,000
- Separate enforcement action against consultant
  - Disgorgement of \$2.4 million in compensation plus interest and barred from association with any securities firm

## In the Matter of Blackstreet Capital Management, LLC et al., Exchange Act Release No. 77959 (June 1, 2016)

- Administrative cease-and-desist proceeding against private equity fund adviser and managing member/principal owner
- SEC found firm engaged in brokerage activity and charged fees without registering as a broker-dealer
- Rather than employing investment banks or broker-dealers to provide brokerage services with respect to acquisition and disposition of securities of portfolio companies, firm performed services in-house
  - Firm solicited deals, identified buyers or sellers, negotiated and structured transactions, arranged financing, and executed transactions
  - All broker fees were fully disclosed to investors
- Other violations included charging oversight fees not disclosed to investors, and taking actions contrary to terms of limited partnership agreement without obtaining investor consent
- Firm and principal ordered to disgorge \$2.3 million plus interest and pay \$500,000 civil money penalty

# Lawyers Offered EB-5 Investments as Unregistered Brokers (December 7, 2015)

- SEC brought series of enforcement actions against lawyers across U.S. charged with offering EB-5 investments while not registered as brokers
- EB-5 Immigrant Investor Program provides foreign investors path to U.S. residency by investing in project that creates or preserves at least 10 jobs for U.S. workers
- SEC's orders stated:
  - Various EB-5 regional centers paid commissions to attorney or law firm for new investors they sold LP interests
  - Payments were separate from legal fees received to provide legal services to the same clients
  - Lawyers and law firms engaged in activities necessary to effectuate the transactions, such as recommending one or more EB-5 investments, acting as liaison between regional center and the investor, or facilitating transfer or documentation of investment funds to the regional center

# Determining whether a finder is an unregistered B-D (securities offerings)

# Main factors

- Transaction-based compensation
- Solicitation of potential investors
- Advice and negotiations
- Prior securities sales experience and disciplinary actions

*Finders exception is not codified. It exists only through the SEC No-Action Letters.*



# Transaction-based compensation

- Single most important factor
- The amount of compensation in absolute terms or relative to the finder's total income is not relevant
- John W. Loofbourrow Associates, Inc. SEC No-Action Letter (June 2006)
- Paul Anka SEC No-Action Letter (July 24, 1991) would probably not be issued today

# Fixed fee compensation

- The SEC is more likely to allow some kind of fixed fee arrangement:
- Dana Investment Advisors, Inc. SEC No-Action Letter (Oct. 12, 1994) – a fee up to 0.07% per annum of the fund's assets
- Colonial Equities Corp. SEC No-Action Letter (June 28, 1988) – fixed fees that could be adjusted once in each 12-m period

# Solicitation of Potential Investors

- Generally, solicitation can be any action designed to persuade or incentivize another person to purchase a security (emails, newspaper ads)
- Brumberg, Mackey & Wall, PLC  
SEC No-Action Letter (May 17, 2010) (pre-screening of potential investors to determine their eligibility to participate in the offer)

# Advice and Negotiations

- Providing advice, particularly about the value of the securities involved
- Assisting investors in negotiating the terms of a sale of securities
- Structuring the transaction
- Making recommendations
- Hallmark Capital Corporation No-Action Letter (June 11, 2007)
- BUT, ministerial functions of facilitating the exchange of documents or information are permitted (Samuel Black, SEC No-Action Letter (Dec. 20, 1976 )

# Prior securities sales experience and disciplinary actions

- Rodney B. Price and Sharod & Assocs., SEC No-Action Letter (Nov. 7, 1982)

# Guidelines for Finders

- Only make introductions to suitable, accredited investors
- Do not solicit or pre-screen investors
- Do not participate in any negotiations
- Do not handle funds
- Non-contingent fixed fee is OK if not based on the success of the deal.
- OK to perform ministerial functions of facilitating the exchange of documents or information

# SEC and FINRA Regulatory Guidance

# M&A Brokers

- The sale of all or a controlling interest in a business is a securities transaction.
- SEC Trading and Markets Division, No-Action Letter (Jan. 31, 2014).
- North American Securities Administrators Association (NASAA) has proposed a uniform state model rule.
- Foreign M&A Brokers, No-Action Letter (May 28, 2013).



# M&A Brokers

- SEC No-Action Letter, Key Conditions:
  - Cannot bind a party to the M&A transaction
  - Will not provide financing
  - Will not have custody, control or possession of securities or funds
  - No shell companies
  - No public offering
  - Disclosure and consent in joint representation
  - Will not form a group of buyers
  - Buyer will control and actively operate the business
  - Restricted securities
  - Not barred or suspended from association with a broker-dealer

# FINRA Rule 2040

- Registered broker-dealers may not pay "any compensation, fees, concessions, discounts, commissions or other allowances to any person that is not registered as a broker-dealer but, by reason of receipt of any such payments and the activities related thereto, is required to be so registered under applicable federal securities laws and Exchange Act rules and regulations."
- Must look to SEC rules to determine whether activities require registration.

# Capital Acquisition Broker

- A separate rule set to apply to firms that meet the definition of a “capital acquisition broker.”
- Capital acquisition broker is any broker that solely engages in one or more of the following activities:
  - Advising an issuer on its securities offerings or capital raising
  - Advising a company on its purchase or sale of a business or its restructuring
  - Advising a company on its selection of an investment banker
  - Assisting in the preparation of offering materials
  - Providing fairness opinions, valuation and other related services
  - Qualifying, identifying, soliciting, or acting as a placement agent or finder
  - Effecting securities transactions solely for transfer of ownership and control

# Exemptions from Broker-Dealer Registration Requirements

# Exemptions from Broker-Dealer Registration Requirements

- Intrastate broker-dealers
  - All aspects of all transactions must be done within one state
- Dealing only in exempted securities
  - Example: commercial paper, bankers' acceptances, short-term debt obligations
  - Government securities brokers are still subject to limited registration under Section 15C of the Exchange Act
  - Brokers dealing in municipal securities are not exempt

# Exemptions from Broker-Dealer Registration Requirements

- Foreign Broker-Dealers: safe harbor Rule 15a-6 of the Exchange Act
  - Unsolicited transactions
  - Research reports to major US institutional investors
  - Transactions with US institutional investors through a US registered broker-dealer
  - Dealing directly with certain categories of US investors

# Exemptions from Broker-Dealer Registration Requirements

- Issuers
- Associated Persons of the Issuers: safe harbor Rule 3a4-1 of the Exchange Act
  - Each of three general conditions must be met:
    - Not subject to statutory disqualification
    - No commissions or other transaction-based comp
    - Are not associated persons of a broker-dealer
  - One of three alternative sets of restrictions on sales activities must be met: see Rule 3a4-1

# Exemptions Available to Online Investment Portals



# Before the JOBS Act

- The following no-action letters only addressed the issue of general solicitation and advertisement, but became models for online investment portals
  - IPOnet, SEC No-Action Letter (July 26, 1996)
    - IPOnet was wholly owned by a registered B-D
  - Lamp Technologies, Inc. SEC No-Action Letter (May 29, 1997)
    - Lamp Technologies was not a registered B-D or affiliated with one

# Before the JOBS Act (cont' d)

- Progressive Technology, Inc., SEC No-Action Letter (October 11, 2000)
  - No-action relief denied because portal planned to actively solicit investors and provide advice to issuers on preparing offering materials
- Angel Capital Elec. Network (“AceNet”), SEC No-Action Letter (October 15, 1996)
  - No-action relief granted because of non-profit nature of the matchmaking network

# Title II Crowdfunding Portals

- Section 201(c) of Title II of the JOBS Act / Section 4(c) of the Securities Act
- An online investment portal is not required to register as a broker-dealer so long as:
  - Does not receive compensation in connection with the purchase and sale of securities and
  - Does not have possession of customer funds or securities.
  - Subject to statutory disqualifications
  - Exemption applies only to Rule 506 offerings
  - OK to co-invest in such securities
  - OK to provide ancillary services (but not advice)

# Relevant SEC No Action Letters and FAQ

- FundersClub Inc. and FundersClub Management LLC SEC No Action Letter (March 26, 2013)
- AngelList LLC and AngelList Advisors LLC SEC No Action Letter (March 28, 2013)
- February 5, 2013 SEC FAQs

# Summary Recommendations

- No broker-dealer registration is required for an online investment portal if the following conditions are met:
  - There is no transaction-based compensation (i.e., fees are not contingent upon the outcome or success of the offerings), but carried interest is OK.
  - The portal does not participate in any negotiations between the companies and the investors or structuring of the deals.
  - The portal does not handle funds or securities involved in the transactions.
  - The portal does not hold themselves out as providing any securities-related service other than a listing or a matching service, but ancillary services are OK.
  - The portal does not provide advice about the merits of a particular opportunity or investment.

# Title III Crowdfunding Portals

- Rule: all crowdfunding transactions under Section 4(a)(6) of the Securities Act must be effected through an intermediary that is either a registered broker or a funding portal under Securities Act Section 4A(a)(1) and Rule 400 of Regulation Crowdfunding
- Funding portals must be registered with the SEC and FINRA. There are 34 registered funding portals as of 11/06/2017.

# Rule 402 Safe Harbor

- Rule 402(b)(1): limiting offerings
- Rule 402(b)(2): highlighting issuers and offerings
- Rule 402(b)(3): providing search functions for investors
- Rule 402(b)(4): providing communication channels
- Rule 402(b)(5): advising issuers
- Rule 402(b)(6): paying for referrals
- Rule 402(b)(9): advertising
- Rule 402(b)(10): denying access to platform
- Rule 402(b)(11): accepting investor commitments
- Rule (402)(b)(12) and (13): directing transmission of funds

# SEC OCIE Examination of Broker-Dealer Issues in Private Investment Funds



- A. Private Funds
- B. OCIE National Examination Program  
Examination Priorities
- C. Examination and Enforcement

# Private Funds

- Speech by David W. Blass, Chief Counsel, SEC Division of Trading and Markets (April 5, 2013)
- Ask the following questions to help determine whether capitalraising activities require broker-dealer registration:
  - How does adviser solicit and retain investors?
    - Dedicated sales force is problematic regardless of how compensated
  - Do employees who solicit investors have other responsibilities?
    - Primary function soliciting investors is problematic
  - How are personnel who solicit investors compensated?
    - Bonuses or other compensation linked to successful investments are problematic
  - Does private fund or adviser charge transaction fee linked to investment in fund?
    - If so likely acting as broker-dealer in sale of fund interests to investors

# Private Funds

- Rule 3a4-1 safe harbor not generally used by private fund advisers – difficulty meeting one of three conditions of rule limiting employee solicitation activities
  - Nuances:
    - Employees with multiple functions
    - Bonuses to employees with multiple functions for overall performance including soliciting investments
- Investment banking activities related to fund’s portfolio companies
  - Fees paid to fund adviser in connection with acquisition, disposition, initial public offering or recapitalization of portfolio companies
    - Viewed as transaction-based compensation linked to securities transaction

# OCIE Exam Priorities

- SEC Office of Compliance Inspections and Examinations (OCIE) National Exam Program Examination Priorities for 2017
  - NEP's Investment Adviser/Investment Company Program will continue to examine investment advisers recently registered under Dodd-Frank Act and to prioritize examinations of private fund advisers where indicia of broker-dealer status concerns present
  - Private Fund Advisers: focus on conflicts of interest and disclosure

# Examination and Enforcement

- FY ended Sept. 30, 2016 – SEC filed record number of enforcement actions (868), including eight against private equity advisers
  - Single-year high
  - Impactful, first-of-their-kind actions in fiscal year 2016 included enforcement proceeding against private equity adviser (Blackstreet Capital Management, LLC ) for acting as unregistered B-D
- FY 2017 discontinuation of SEC’s “broken windows” enforcement policy
  - New Enforcement Division leadership has signaled it is moving away from this program
- OCIE now conducting routine examinations of exempt reporting advisers
  - Venture capital fund advisers and private fund advisers with less than \$150 AUM
  - Policy reversal. Originally examined only “for cause.” Since late 2015, examinations made on routine or risk basis
- How are SEC enforcement and OCIE examination priorities changing under Trump administration and Chairman Clayton?

# Other Developments

# Other Developments

- American Bar Association, Section of Business Law - Report and Recommendations of the Task Force on Private Placement Broker-Dealers (June 30, 2005)
  - SEC, NASD and state regulators work to establish a simplified system for registration for private placement broker-dealers (PPBDs) (unregistered securities brokers who raise funds for small businesses or engage in mergers and acquisition activities on commission basis).
  - Requirements or criteria for PPBD firms and principals:
    - No participation in registered public offerings
    - No statutory disqualifications
    - Offerings only to accredited investors and qualified purchasers
    - Not handle or take possession of funds or securities
    - All offerings on best efforts basis
    - Offering proceeds placed in escrow in unaffiliated financial institution
    - No secondary market or trading activity
    - Successful completion of appropriate NASD examinations
    - Develop new examinations for registered representatives and principals of PPBDs

# Other Developments

- American Bar Association, Section of Business Law - Report and Recommendations of the Task Force on Private Placement Broker-Dealers (June 30, 2005)
  - Adopt rules or issue clarifying release relating to business brokers
  - Issue SEC/NASAA explanatory release clarifying requirements for circumstances under which transaction-based compensation is appropriate
  - Exemption for M&A transactions with single entity buyer
  - Create environment where applicants want to register
  - FINRA and NASAA cooperation in implementation of process



# Recent Developments

- SEC Advisory Committee on Small and Emerging Companies
  - Recommendations Regarding the Regulation of Finders and Other Intermediaries in Small Business and Capital Formation Transactions (Sept. 23, 2015; May 15, 2017).
  - SEC to clarify 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 B-D registration under the Exchange Act.
  - SEC exempt intermediaries actively involved in discussions, negotiations and structuring, as well as solicitation of prospective investors, for private financings on a regular basis from B-D registration at the federal level, conditioned upon registration under state law.
  - SEC spearhead joint effort with North American Securities Administrators Association (NASAA) and Financial Industry Regulatory Authority (FINRA) to ensure coordinated state regulation and adoption of measured regulation
  - SEC to begin addressing issues regarding regulation of intermediaries in small business capital formation transactions incrementally instead of waiting for development of comprehensive solution.

# Thank You

---

**Parker B. Morrill**

Associate

Clyde Snow & Sessions  
201 South Main Street, Suite 1300  
Salt Lake City, Utah 84111

**T** (801) 322-2516

**F** (801) 521-6280

**E** [pbm@clydesnow.com](mailto:pbm@clydesnow.com)

**W** [www.clydesnow.com](http://www.clydesnow.com)



**Arina Shulga**

Partner

Ross & Shulga PLLC  
75 Maiden Lane, Suite 903  
New York, NY 10038

**T** (212) 379-6755

**F** (646) 453-7669

**E** [arina@Rsglobal.law](mailto:arina@Rsglobal.law)

**W** [www.Rsglobal.law](http://www.Rsglobal.law)

