

Small Business Notes

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U.S. Securities and Exchange Commission Proposes New Rule Exempting “Finders” From Registration

On October 7, the Securities and Exchange Commission proposed an exemption from broker-dealer registration for “finders” who assist small businesses with capital formation. The proposed exemption creates both Tier I and Tier II finders. A Tier I finder would be limited to providing the contact information of potential accredited investors to a single issuer in a single capital raising transaction in a twelve month period. A Tier I finder would be prohibited from having any contact with a potential investor about the issuer. A Tier II finder could solicit investors of investors on behalf of the issuer but would be limited in its activities to 4 activities: identifying, screening, and contacting investors; distributing offering material to investors; discussing offering materials provided that the finder does not provide any investment advice as to valuation of the investment or its advisability; arranging and participating in meetings with the issuer and investor.

For both Tier I and Tier II the exemption is only available where:

- The issuer is not required to file reports under section 13 or section 15 of the Exchange Act;
- The finder does not engage in general solicitation;
- The issuer is seeking to offer securities under one of the exemptions from registration provided for in the Securities Act;
- The potential investor is an accredited investor as defined in Regulation D or the finder has a reasonable belief that the investor is accredited;
- The finder is a natural person, not associated with a broker-dealer, who provides services pursuant to a written agreement with the issuer stating the services to be provided and the compensation to be received;
- The finder is not subject to a statutory disqualification or discipline;
- The finder is not involved in structuring the transaction or negotiating the terms of the offering; does not handle customer funds or securities or bind the either the issuer or investor; does not perform any independent analysis of the offering or sale; does not engage in any due diligence; and does not provide financing for the transaction.

A Tier II finder must also disclose, before or at time of solicitation, the finder’s role and compensation and receive from the investor, prior to or at time of investment, a dated written acknowledgement of the receipt of those disclosures.

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Finders Proposed Exemptive Order: Overview Chart of Tier I Finders, Tier II Finders and Registered Brokers

The below chart¹ provides a summary overview of some of the permissible activities, requirements, and limitations outlined in the [proposed exemptive order](#) granting a conditional exemption from broker registration for finders.² The proposed exemptive order has not been finalized and remains subject to change. Finders may not rely on the proposed exempt activities, requirements, and limitations outlined below until such time they are made part of a final operative exemptive order, if any, issued by the Commission.

		Proposed Finder Safe Harbors		Registered ³ Brokers
		Tier 1 Finders	Tier 2 Finders	
WHO	Natural person	✓	✓	✓
	Entities (including crowdfunding platforms)			✓
	Associated person of a broker-dealer			✓
\$	Transaction-based compensation	✓	✓	✓
INVESTORS	Accredited investors	✓	✓	✓
	Non-accredited investors			✓
ISSUER	Non-reporting (private) company	✓	✓	✓
	Reporting (public) company			✓
OFFERING	Primary exempt offerings	✓	✓	✓
	Secondary sales			✓
	Registered offerings (e.g., IPOs, follow-on offerings)			✓
PERMITTED ACTIVITIES	Provide investor contact information to issuer	✓	✓	✓
	Identify, screen, and contact potential investors		✓	✓
	Distribute issuer offering materials to investors		✓	✓
	Discuss issuer information included in offering materials		✓	✓
	Arrange or participate in meetings with the issuer and investor		✓	✓
	Structure the transaction or negotiate the terms of the offering			✓
	Engage in general solicitation			✓
	Handle customer funds or securities			✓
	Power to bind the issuer or the investor			✓
	Participate in the preparation of sales materials			✓
	Perform independent analysis of the sale			✓
	Engage in due diligence activities			✓
	Assist or provide financing for investment purchases			✓
	Provide advice as to the valuation or financial advisability of the investment			✓
May participate in more than one capital raising transaction within a 12 month period		✓	✓	

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		Proposed Finder Safe Harbors		Registered ³ Brokers
		Tier 1 Finders	Tier 2 Finders	
OTHER TERMS OF EXEMPTION	Anti-fraud protections apply	✓	✓	✓
	Written agreement with issuer required	✓	✓	*
	Written disclosure to investors required		✓	✓**
	No statutory disqualification	✓	✓	✓

* Depending on the activities a registered broker engages in, it may be required to enter into a written agreement with an issuer.

** While the proposed exemptive order prescribes clear disclosure criteria required of Tier II Finders, whether and the extent to which a broker-dealer is required to provide disclosures is generally based on the nature of the transaction and the rules and provisions of the Exchange Act that apply to the specific transaction.

1 This chart was created by the Office of the Advocate for Small Business Capital Formation and highlights several of the proposed terms of the conditional exemption from broker registration. It is not a rule, regulation, or statement of the Securities and Exchange Commission (“Commission”). The Commission has neither approved nor disapproved its content. This chart, like all staff guidance, has no legal force or effect: it does not alter or amend applicable law, and it creates no new or additional obligations for any person. We encourage you to look at the proposed exemptive order for more details and to share your feedback!

2 As described in the proposed exemptive order, the Commission has not broadly addressed the other types of specific activities that might implicate the Commission’s regulatory regime for brokers. Activities that go beyond the scope of the proposed safe harbors outlined herein (and any that may be adopted) and ultimately whether a person is a broker within the meaning of Section 3(a) (4) turns on the facts and circumstances of the matter.

3 See 15 U.S. Code § 78o and applicable provisions of the federal securities laws and related rules and regulations. Different types of broker-dealers may engage in different types of activities. For purposes of this chart, we are assuming that a registered broker-dealer satisfies all applicable requirements and has received all necessary approvals to engage in the identified activities. There are a variety of legal requirements, including Commission and FINRA rules, that apply to transactions involving registered broker-dealers, not all of which are highlighted in this comparative finders chart. For additional information on registration as a broker-dealer, see the Division of Trading and Markets’ [Guide to Broker-Dealer Registration](#).

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CDC Provides New Definition of “Close Contact” for COVID-19 Prevention

Amid the continuing discussions about masking, distancing, and contact tracing in response to the COVID virus, the Center for Disease Control on October 21 released a new definition of “close contact” to be avoided as a way to prevent exposure to the disease.

Under the previous definition close contact was defined as exposure within six feet of an infected (or believed to be infected) individual for a continuous period of fifteen minutes or more. The new definition seeks to account for cumulative exposures a person may have had with an infected or believed to be infected person. The new definition defines close contact as being within six feet for a cumulative total of fifteen minutes or more over a twenty four hour period beginning two days before the onset of illness. Multiple brief interactions with an infected individual—for example an exposure of ten minutes and an exposure later of five minutes – would be summed together to reach the fifteen minutes in twenty four hours standard.

The new definition will have an effect on contact tracing and, when considered along with other factors such as exposure to unmasked respiratory droplets in the context of coughing, sneezing, shouting, or singing, can affect on workplace practices such as time of exposure and creation of additional hard barriers between workers.

UPDATE: Lawsuit Challenges Executive Order 13950

As noted in *Small Business Notes* for October, on September 22, the President issued Executive Order 13950 barring federal contractors and grantees from conducting certain kinds of diversity and inclusion training. Prohibited is any training which can be seen to have as its premise “...the pernicious and false belief that America is an irredeemably racist and sexist country; that some people, simply on account of their race or sex, are oppressors; and that racial and sexual identities are more important than our common status as human beings and Americans”

On October 29th the National Urban League and the National Housing Alliance filed suit in federal court challenging the constitutionality of the Executive Order and seeking injunctive and declaratory relief to prevent its implementation and enforcement.

The plaintiffs argument is based on both First Amendment grounds: that the order prohibits and censors protected speech (the concepts like those above which the Executive Order identifies as “divisive” in nature); and also on Fifth Amendment grounds (that the language of the Executive Order deprives protected classes of individuals of protection against hate speech and other discriminatory language).

The Executive Order does not apply to contracts or grants executed before November 22, 2020. Both the constitutional challenge and the outcome of the 2020 presidential election may have substantial effect on its future.

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New SEC Rule Addresses Securities Offering Limits and Individual Investor Limits

On November 2nd, the U.S. Securities and Exchange Commission released a lengthy (383 pages) final rule addressing the harmonization of requirements across various exemptions from securities registration. The final rule continues the discussion first begun in the SEC's 2019 harmonization concept (see Small Business Notes for March 2019).

While the final rule addressed many issues, the most immediate for potential users of exemptions from registration will be the increased offering limits for securities offered under Regulation A Tier 2, Rule 504 of Regulation D, and Regulation Crowdfunding. In the economic analysis included in the rulemaking, the SEC notes that "...most issuers that rely on Regulation A, Regulation Crowdfunding, and Rule 504 tend to raise amounts of funding... that are below the existing offering limits...It is likely that issuers with larger financing needs forgo the exemptions with offering limits that are too low for their financing needs. Expanding the offering limits is therefore expected to attract additional issuers to these exemptions."

Under the new rule:

- The Regulation A Tier 2 offering limit is increased from \$50 million to \$75 million and the limit
- On secondary sales is increased from \$15 million to \$22 million.
- The Rule 504 offering limit is increased from \$5 million to \$10 million.
- The Regulation Crowdfunding offering limit is increased from \$1.7 million to \$5 million.

In addition the final rule removed all dollar investment limits on individual accredited investors and provided that non-accredited investors may use the greater of their income or net worth in computing their investment limit under the regulation.

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