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Proposed Legislation Would Create a Tiered Exemption from Broker Registration

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In 2022, Congress codified an exemption from registration for M&A brokers. This year, another bill seeks to go further. Division B, Title I, the Unlocking Capital for Small Businesses Act of 2023 (the "Unlocking Capital Act"), is part of H.R. 2799, the Expanding Access to Capital Act. The Unlocking Capital Act has cleared the House Financial Services Committee on a straight party-line vote (including party-line votes rejecting three amendments). The Expanding Access to Capital Act may advance to a House floor debate this fall. There is currently no companion Senate bill. While significant impediments to passage remain ahead for the Unlocking Capital Act, if enacted, the Unlocking Capital Act would establish two investment professional categories—private placement brokers and finders. The legislation would allow these professionals to engage in many activities that, due to investor protection concerns, have been regulated for almost a century. The Unlocking Capital Act would make the following changes to state and federal securities laws:

- Amend Section 15 of the Securities Exchange Act of 1934 ("Exchange Act") to add a registration safe harbor and disclosure regime for private placement brokers.
- Amend Exchange Act Section 15 to add a nonregistration safe harbor for finders.
- Amend the definition of "financial institution" in Section 5312 of Title 31, United States Code, to exempt "private placement brokers" from being categorized as financial institutions.
- Amend Exchange Act Section 3(a)(4) to add "private placement brokers" to the list of exceptions from the Exchange Act broker definition.
- Amend Exchange Act Section 29 to protect issuers from voided contracts. To be eligible, issuers must:

– obtain self-certification by the private placement broker/ finder of their status; and

– be unaware or have no reasonable basis to believe the self-certification is false.

- Amend Exchange Act Section 15 to preempt state and local governments from enforcing laws or procedures in excess of those required by the Unlocking Capital Act.

The Unlocking Capital Act defines a “private placement broker” in three parts. First, such brokers are persons who receive transaction-based compensation for effecting transactions. Applicable transactions include introducing securities issuers and related buyers either (A) for the sale of a business effected through the sale of securities; or (B) for the placement of securities that are exempt from registration requirements under the Securities Act of 1933 (“Securities Act”). With respect to transactions for which brokers receive transaction-based compensation, private placement brokers are further defined as those who do not handle or possess funds/securities, or engage in any activity that requires investment adviser registration under state or federal law. Finally, private placement brokers cannot be a finder as defined by the Unlocking Capital Act.

The Unlocking Capital Act would also establish a nonregistration safe harbor for finders. The title defines “finders” to be private placement brokers who, in any calendar year, receive transaction-based compensation (A) of equal to or less than $500,000; (B) for transactions that result in a single issuer selling securities valued at equal to or less than $15 million; (C) for transactions that result in any combination of issuers selling securities valued at equal to or less than $30 million; or (D) in connection with fewer than 16 transactions that are not part of the same offering or are otherwise unrelated.

The Unlocking Capital Act would be a significant departure from existing law. For nearly 100 years, individuals serving as private placement brokers and finders have been required to register under the Exchange Act. The Exchange Act’s registration requirements were put in place to deter the rampant fraud, speculation, and market abuses that led to the Great Depression. To this point, ranking committee member Rep. Maxine Waters has said that the Expanding Access to Capital Act would “significantly weaken investor protections by removing the very disclosures and legal protections investors rely on to hold businesses accountable.” Under current regulations, individuals acting as private placement brokers and finders must first pass numerous industry exams and background checks to demonstrate competency before selling private securities. Professionals must also take yearly continuing education courses, and the public can readily check broker credentials on brokercheck.finra.org.

Regulators currently enforce rules meant to protect investors in these markets. Materials used to market private placements are subject to content rules, collected and reviewed by the Financial Industry Regulatory Authority. Removing regulatory oversight shifts a greater burden of diligence onto investors. Current regulations also prohibit excessive compensation to private placement brokers and finders; enforce cybersecurity and customer data protection; and support anti-money laundering and anti-theft protections. For example, most broker-dealers engaging in private placements are prohibited from accepting customer funds. Instead, these funds must go to the issuer directly or into an escrow account. Without such requirements in place investors’ funds could be diverted to an unscrupulous agent.

Some critics of the Unlocking Capital Act believe that the legislation will facilitate further growth of unregulated markets and weaken the government’s oversight of those who market risky investments to retail investors. Other critics, like the North American Securities Administrators Association (NASAA), oppose the Unlocking Capital Act because, if passed, state governments could no longer

require finders to apply to be registered or licensed with the state before they began to solicit investors in the states. Such legislation would strip states of their authority to decide how best to structure regulatory frameworks appropriate for the different types of activities conducted by investment professionals. NASAA has also pointed out that self-certification is not an effective disclosure regime and will be ineffective in protecting investors because there is no way of knowing if finders are adhering to limitations.

Other industry groups may voice similar concerns in the near future.

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