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ARTICLE

THE "FINDER'S" EXCEPTION FROM FEDERAL BROKER-DEALER REGISTRATION

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I. INTRODUCTION

Brokers and dealers in securities have been required to register with the Securities and Exchange Commission (Commission) since 1935.¹ The original section 15 of the Securities Exchange Act of 1934 (Exchange Act or Act) authorized the Commission to adopt rules requiring registration by broker-dealers that were not already members of the securities exchanges.² In 1936, Congress amended section 15 to codify, for the most part, the rules adopted by the Commission one year earlier.³

The federal broker-dealer registration requirements are consistent with the lofty purposes of the Exchange Act, which include "protecting the public . . . with respect to trading in securities, through . . . the regulation of brokers and dealers and the securities markets."⁴ The statutory definitions designating the persons⁵ subject to these requirements are broad in scope. A "broker" under the Act is "any person engaged in the business of effecting

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1. Securities Exchange Act of 1934, Pub. L. No. 73-291, § 15, 48 Stat. 881, 895-96 (1934) (current version at 15 U.S.C. § 78o(a)(1) (1988)).

2. *Id.*

3. Act of May 27, 1936, Pub. L. No. 74-621, § 3, 49 Stat. 1375, 1377 (amending Securities Exchange Act of 1934); see also S. Rep. No. 1739, 74th Cong., 2d Sess. 3-4 (1936); H.R. Rep. No. 2601, 74th Cong., 2d Sess. 4-5 (1936).

4. EZRA WEISS, REGISTRATION AND REGULATION OF BROKERS AND DEALERS, xii (1965).

5. A "person" for purposes of the Act is "a natural person, company, government, or political subdivision, agency, or instrumentality of a government." 15 U.S.C. § 78c(a)(9) (1988).

transactions in securities for the account of others,"⁶ but the statutory definition does not include banks.⁷ A "dealer," on the other hand, is a "person engaged in the business of buying and selling securities for his own account, through a broker or otherwise."⁸ Finally, section 15 of the Exchange Act makes it unlawful for any broker or dealer to use "the mails or any means or instrumentality" of interstate commerce⁹ "to effect any transactions in, or to induce or attempt to induce the purchase or sale of," any security,¹⁰ other than exempted securities,¹¹ commercial paper, bankers' acceptances, and

6. 15 U.S.C. § 78c(a)(4) (1988).

7. A "bank" for purposes of the Act is:

(A) a banking institution organized under the laws of the United States, (B) a member bank of the Federal Reserve System, (C) any other banking institution, whether incorporated or not, doing business under the laws of any State or of the United States, a substantial portion of the business of which consists of receiving deposits or exercising fiduciary powers similar to those permitted to national banks under section 11(k) of the Federal Reserve Act, as amended, and which is supervised and examined by State or Federal authority having supervision over banks, and which is not operated for the purpose of evading the provisions of [the Exchange Act], and (D) a receiver, conservator, or other liquidating agent of any institution or firm included in clauses (A), (B), or (C) of this paragraph.

15 U.S.C. § 78c(a)(6) (1988). Associated persons of an issuer of securities who sell only that issuer's securities are, in certain circumstances, exempt from the definition of broker. 17 C.F.R. § 240.3a4-1 (1991).

8. 15 U.S.C. § 78c(a)(5) (1988). The definition "does not include a bank, or any person insofar as he buys or sells securities for his own account, either individually or in some fiduciary capacity, but not as part of a regular business." *Id.* Although the explicit language of this definition is broad, the Commission has noted that "it has been interpreted to exclude various activities not within the intent of the definition, such as buying and selling for investment." Registration Requirements for Foreign Broker-Dealers, Exchange Act Release No. 27,017 (July 11, 1989), 54 Fed. Reg. 30,013, 30,015 n.17 (1989) (citing United Savings Association of Texas, SEC No-Action Letter, 1987 SEC No-Act. LEXIS 2021 (Apr. 2, 1987); William O. Douglas & George E. Bates, *Some Effects of the Securities Act Upon Investment Banking*, 1 U. CHI. L. REV. 283, 302 n.68 (1934); William O. Douglas & George E. Bates, *The Federal Securities Act of 1933*, 43 YALE L.J. 171, 206 n.189 (1933)).

9. 15 U.S.C. § 78o(a)(1). "Interstate commerce," for purposes of the Act, is defined as: trade, commerce, transportation, or communication among the several States, or between any foreign country and any State, or between any State and any place or ship outside thereof, [including] intrastate use of (A) any facility of a national securities exchange or of a telephone or other interstate means of communication, or (B) any other interstate instrumentality.

15 U.S.C. § 78c(a)(17) (1988). The Act specifically excludes "a broker or dealer whose business is exclusively intrastate and who does not make use of any facility of a national securities exchange." 15 U.S.C. § 78o(a)(1).

10. "Security" is defined in section 3(a)(10) of the Exchange Act. 15 U.S.C. § 78c(a)(10) (1988).

11. The terms "exempted security" and "exempted securities" are defined in section 3(a)(12) of the Exchange Act. 15 U.S.C. § 78c(a)(12) (1988).

commercial bills,¹² unless the broker or dealer is registered with the Commission.¹³

Registration serves important purposes and has a central place in the federal regulatory system governing broker-dealers. Finders, however, have perennially maintained that they are not subject to the broker-dealer registration requirements. Finders argue that they are not engaged in the business of effecting securities transactions, because they merely "find" and place in contact with each other, for a fee, potential buyers and sellers of securities who will then complete any resulting transactions.¹⁴ A coherent interpretation of the broker-dealer registration requirements, as applied to finders, necessitates a precise definition of the meaning of "effecting" transactions. If precision is impossible or ultimately undesirable, a principled justification for interpreting the term broadly or narrowly should be established.

Accordingly, this article analyzes the Commission's administrative decisions, the "no-action" letters issued by the Commission's staff,¹⁵ and the handful of relevant cases discussing the application of the federal broker-dealer registration requirements to finders. Three general classes of finders are identified: (i) finders for registered broker-dealers, including licensed professionals, other non-brokerage businesses, depository institutions, and com-

12. Commercial paper, bankers' acceptances, and commercial bills are not defined in the Exchange Act. Nonetheless, the Commission has recognized that "the definition of 'security' in section 3(a)(10) of the Exchange Act . . . generally is understood to exclude instruments exempt from registration under section 3(a)(3) of the Securities Act [of 1933] . . . by virtue of their classification as commercial paper." Exchange Act Release No. 27,017, 54 Fed. Reg. 30,015 n.21 (citing Registration Exemption for Short-Term Paper, Securities Act Release No. 4412, [1957-1961 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,786 (Sept. 20, 1961)); *Sanders v. John Nuveen & Co.*, 463 F.2d 1075 (7th Cir.), *cert. denied*, 409 U.S. 1009 (1972).

13. 15 U.S.C. § 78o(a)(1).

14. See Gregory S. Crespi, *The Reach of the Federal Registration Requirements for Broker-Dealers and Investment Advisers*, 17 SEC. REG. L.J. 339, 344-48 (1990); Denis T. Rice, *The Expanding Requirement for Registration as "Broker-Dealer" Under the Securities Exchange Act of 1934*, 50 NOTRE DAME LAW. 201 (1974).

15. A "no-action" letter is a response from the staff of the Commission to an inquiry requesting assurances in connection with a proposed transaction implicating the federal securities laws. Based on the facts and representations set forth in the inquiry, the staff states that it will not recommend enforcement action to the Commission if the parties making the request proceed as they describe, without complying with specific statutory or regulatory provisions of those laws. A no-action letter represents the staff's position concerning enforcement action only, and it is not a legal opinion. See Thomas P. Lemke, *The No-Action Letter Process*, 42 BUS. LAW. 1019 (1987). In addition, the staff's no-action positions may not be deemed agency action, at least for purposes of judicial review. See *Board of Trade v. SEC*, 883 F.2d 525, 529-31 (7th Cir. 1989); *Kixmiller v. SEC*, 492 F.2d 641 (D.C. Cir. 1974). *But see* *Medical Committee for Human Rights v. SEC*, 432 F.2d 659 (D.C. Cir. 1970), *vacated as moot*, 404 U.S. 403 (1972) (finding that Commission's review of staff's action concerning shareholder proposal was an administrative action subject to review).

mon-interest groups;¹⁶ (ii) finders for issuers, including persons who promote the sale of a new issue of securities, financial advisers who provide consulting services regarding the issuance of securities, persons who facilitate merger and acquisition activities, so-called "business brokers," and persons who match investors with entrepreneurs seeking financing;¹⁷ and (iii) finders for investors, including listing services and trading systems.¹⁸ The purpose of this analysis is to determine whether each class of finders should be treated as not "engaged in the business of effecting transactions in securities," and thus properly deemed outside the scope of the definition of broker in section 3(a)(4) of the Exchange Act.¹⁹

In particular, this article will consider whether the activities of the members of each class are sufficiently limited to justify being outside the reach of the Act. This article will also address whether the nature of finders' compensation offers them incentives to exceed those limits. It will also consider whether the meaning of "effecting" transactions can be clarified, and whether the rationale for requiring broker-dealer registration can be elucidated. The article concludes that public policy, while supporting a broad construction of the phrase "effecting transactions in securities," also supports a limited exception from the broker-dealer registration requirements for legitimate finders, depending on the nature of their activities and their compensation.

II. OVERVIEW OF FEDERAL BROKER-DEALER REGULATION

A. Purposes and Scope

The rationale for broker-dealer registration is directly related to both the public interest and the protection of investors, even though Congress has not clearly elucidated this relationship.²⁰ Congress repeatedly has confirmed the importance of registration, however, by requiring registration of exchange

16. See *infra* notes 62-161 and accompanying text.

17. See *infra* notes 162-209 and accompanying text.

18. See *infra* notes 210-30 and accompanying text.

19. 15 U.S.C. § 78c(a)(4). The interpretation of the definition of dealer in section 3(a)(5) of the Act is beyond the scope of this article. 15 U.S.C. § 78c(a)(5).

20. Congress has never fully articulated its goals in requiring broker-dealer registration because of the tentative manner in which the current scheme for broker-dealer registration evolved. Congress did view the registration requirement, however, as an element of the overall mechanics of regulating trading in over-the-counter securities. Regulation of the over-the-counter market was necessary to discourage listed issuers and traders of listed securities from the temptation of avoiding the discipline of the exchanges. DAVID A. LIPTON, BROKER-DEALER REGULATION, § 1.03, at 1-10 (15 Securities Law Series 1988).

members, specialists, floor brokers, and traders on the exchanges,²¹ municipal securities dealers,²² and government securities brokers and dealers.²³ The Commission views broker-dealer registration as essential to protecting prospective purchasers of securities.²⁴

Indeed, the Commission has stated that the "requirement that non-exempt broker-dealers register as such is a keystone of the entire system of broker-dealer regulation."²⁵ Each registered broker-dealer must join either a registered national securities association²⁶ or a registered national securities exchange,²⁷ depending on whether the broker-dealer trades securities over-the-counter or listed on that exchange.²⁸ It is through membership in these self-regulatory organizations (SROs)²⁹ that broker-dealers become subject to standards of professional competence,³⁰ disciplinary standards restricting entry into the securities business,³¹ rules governing their sales practices,³² requirements for fidelity bonds,³³ and fingerprinting of securities industry personnel.³⁴

21. Securities Acts Amendments of 1975, Pub. L. No. 94-29, § 11, 89 Stat. 97, 121-27 (1975).

22. *Id.* § 13, 89 Stat. at 131-37.

23. Government Securities Act of 1986, Pub. L. No. 99-571, § 101, 100 Stat. 3208 (1986).

24. "[N]o amount of disclosure in a prospectus can be effective to protect investors unless the securities are sold by a salesman who understands and appreciates both the nature of the securities he sells and his responsibilities to the investor to whom he sells." Persons Deemed Not To Be Brokers, Exchange Act Release No. 20,943 (May 9, 1984), 49 Fed. Reg. 20,512, 20,515 (1984) (quoting *Report of Special Study of Securities Markets*, H.R. DOC. No. 94, 88th Cong., 1st Sess., pt. 1, at 588 (1963)).

25. Frank W. Leonesio, Exchange Act Release No. 23,524, 36 SEC Docket 457, 464 (Aug. 11, 1986); Eugene T. Ichinose, Jr., Exchange Act Release No. 17,381, 21 SEC Docket 970, 975 (Dec. 16, 1980).

26. Exchange Act, § 15A, 15 U.S.C. § 78o-3 (1988). Only the National Association of Securities Dealers, Inc. (NASD) has qualified to date.

27. *Id.* § 6, 15 U.S.C. § 78f (1988).

28. *Id.* § 15(b)(8), 15 U.S.C. § 78o(b)(8) (1988).

29. *Id.* § 3(a)(26), 15 U.S.C. § 78c(a)(26) (1988).

30. *Id.* § 15(b)(7), 15 U.S.C. § 78o(b)(7) (1988); see also NASD Schedules to By-Laws, Schedule C, reprinted in NASD Manual (CCH) ¶¶ 1782-1792 (July 1990); New York Stock Exchange, Inc. (NYSE) Rules 10, 345, reprinted in N.Y.S.E. Guide (CCH) ¶¶ 2010, 2345 (Oct. 1989).

31. Exchange Act, § 3(a)(39), 15 U.S.C. § 78(c)(a)(39) (1988) (barring membership in, or association with, a member of an SRO, based on adverse disciplinary history).

32. *E.g.*, NASD Rules of Fair Practice, reprinted in NASD Manual (CCH) ¶¶ 2001-2401 (Jan. 1990).

33. *E.g.*, NYSE Rule 319, reprinted in N.Y.S.E. Guide (CCH) ¶ 2319 (Oct. 1988); NASD Rules of Fair Practice, Art. III, § 32, reprinted in NASD Manual (CCH) ¶ 2182 (May 1988).

34. 17 C.F.R. § 240.17f-2(a) (1991). Rule 17f-2(a) applies, with certain exceptions, not only to partners, directors, officers, and employees of members of national securities exchanges, but also to partners, directors, officers, and employees of every broker, dealer, registered transfer agent, and registered clearing agency. *Id.*

Registration also subjects broker-dealers to the regulatory authority of the Commission. The Commission can discipline registered broker-dealers, and persons associated with them, for violations of statutory and regulatory provisions of the federal securities laws and related requirements.³⁵ Registered broker-dealers must comply with the Commission's financial responsibility rules, which prescribe minimum levels of capital adequacy³⁶ and establish requirements for the maintenance of reserves and the custody of customers' securities.³⁷ Registered broker-dealers also must join the Securities Investor Protection Corporation,³⁸ which insures brokerage customers for the total value of cash and securities in their accounts up to \$500,000, with a limit of \$100,000 on cash.³⁹ The Commission's rules governing registered broker-dealers also regulate their operations,⁴⁰ proscribe their use of "any manipulative, deceptive, or other fraudulent device or contrivance" to effect, induce, or attempt to induce any transaction in securities,⁴¹ and mandate compliance with other important requirements.⁴²

The adverse consequences of failing to register can be severe. The Commission is authorized to seek civil injunctions in federal district court against persons violating or about to violate the provisions of the Exchange Act, including the broker-dealer registration requirements.⁴³ The Commission

35. 15 U.S.C. §§ 78o(b)(4), (6) (1988).

36. 17 C.F.R. § 240.15c3-1 (1991).

37. 17 C.F.R. § 240.15c3-3 (1991).

38. Securities Investor Protection Act of 1970 (SIPA), § 3(a)(2), 15 U.S.C. § 78ccc(a)(2) (1988).

39. SIPA, § 9(a), 15 U.S.C. § 78fff(a) (1988).

40. *See, e.g.*, Rules 17a-3 (recordkeeping), 17a-4 (record preservation), 17a-5 (reporting), 17a-13 (quarterly security counts), 17 C.F.R. §§ 240.17a-3, 17a-4, 17a-5, 17a-13 (1991).

41. Exchange Act, § 15(c)(1), 15 U.S.C. § 78o(c)(1) (1988). Under section 15(c) of the Exchange Act, the Commission is authorized to adopt rules defining and prohibiting use of these devices and contrivances. *Id.*; *see, e.g.*, Rules 15c1-3 (misrepresentation as to registration), 15c1-5 (disclosure of control), 15c1-6 (disclosure of interest in distribution), 15c2-4 (transmission or maintenance of payments received in connection with underwritings), 15c2-6 (sales practice requirements for certain low-priced securities), 15c2-8 (delivery of prospectus), 15c2-11 (initiation or resumption of quotations without specified information), and 15c2-12 (municipal securities disclosure), 17 C.F.R. §§ 240.15c1-3, 15c1-5, 15c1-6, 15c2-4, 15c2-6, 15c2-8, 15c2-11, 15c2-12 (1991).

On occasion courts have found that, regulations aside, a broker-dealer owes a fiduciary duty to its customers because it holds itself out to the public as a securities professional. *See, e.g.*, *Hanly v. SEC*, 415 F.2d 589, 596 (2d Cir. 1969) ("A securities dealer occupies a special relationship to a buyer of securities in that by his position he implicitly represents he has an adequate basis for the opinions he renders.")

42. *See, e.g.*, Rules 14b-1 (prompt forwarding of proxy information to beneficial owners of securities), 17a-8 (financial recordkeeping and reporting of currency and foreign transactions), and 17f-1 (reports and inquiries about missing, lost, counterfeit, or stolen securities), 17 C.F.R. §§ 240.14b-1, 17a-8, 17f-1 (1991).

43. Exchange Act, § 21(d), 15 U.S.C. § 78u(d) (1988).

may seek civil money penalties as well.⁴⁴ The Commission also has the authority, after notice and opportunity for hearing, to issue a cease-and-desist order in response to a violation of these provisions.⁴⁵ In addition, the Commission is authorized to refer the matter to the Attorney General for prosecution.⁴⁶ Finally, failure to register when required is grounds for denial by the Commission of a later application for broker-dealer registration.⁴⁷

Some remedies for customers of unregistered broker-dealers also exist. Generally, courts have not implied a private right of action under Section 15(a).⁴⁸ The reach of section 29(b) of the Exchange Act, which, with certain exceptions, renders void "[e]very contract made in violation of any provision of [the Act],"⁴⁹ has been interpreted, however, to allow rescission of transactions in securities with unregistered broker-dealers.⁵⁰ Damages may be awarded in lieu of rescission,⁵¹ although "in most instances the requisite causal relationship between the plaintiff's injuries and the failure to register would be difficult to establish."⁵² Nonetheless, unregistered broker-dealers

44. *Id.* § 21A, 15 U.S.C. § 78u-1 (1988)

45. *Id.* § 21C, 15 U.S.C. § 78u-3 (1990).

46. *Id.* § 32(a), 15 U.S.C. § 78ff(a) (1988) (conviction for willful failure to register can result in a fine of up to \$1,000,000 (\$2,500,000 for persons other than natural persons) and imprisonment for up to ten years); *see, e.g.*, *Guon v. U.S.*, 285 F.2d 140 (8th Cir. 1960) (imposing sentence of two years' probation for criminal violation of broker-dealer registration requirements).

47. Exchange Act, § 15(b)(4)(C), 15 U.S.C. § 78o(b)(4)(C).

48. *See, e.g.*, *Brannan v. Eisenstein*, 804 F.2d 1041, 1043 (8th Cir. 1986); *Admiralty Fund v. Hugh Johnson & Co.*, 677 F.2d 1301, 1313 (9th Cir. 1982); *Greater Iowa Corp. v. McLendon*, 378 F.2d 783, 789-91 (8th Cir. 1967); *Goodman v. Shearson Lehman Bros., Inc.*, 698 F. Supp. 1078 (S.D.N.Y. 1988); *Baum v. Phillips, Appel & Walden, Inc.*, 648 F. Supp. 1518 (S.D.N.Y. 1986); *Bull v. American Bank & Trust Co. of Pa.*, 641 F. Supp. 62, 65 (E.D. Pa. 1986); *Walck v. American Stock Exch., Inc.*, 565 F. Supp. 1051, 1058-59 (E.D. Pa. 1981), *aff'd*, 687 F.2d 778 (3d Cir. 1982), *cert. denied*, 461 U.S. 942 (1983). *Contra Opper v. Hancock Securities Corp.*, 367 F.2d 157 (2d Cir. 1966).

49. Exchange Act, § 29(b), 15 U.S.C. § 78cc(b) (1988).

50. *See, e.g.*, *Regional Properties, Inc. v. Financial & Real Estate Consulting Co.*, 678 F.2d 552, 558 (5th Cir. 1982); *Eastside Church of Christ v. National Plan, Inc.*, 391 F.2d 357 (5th Cir.), *cert. denied sub nom. Church of Christ v. National Plan, Inc.*, 393 U.S. 913 (1968). *See generally* Samuel H. Gruenbaum & Marc I. Steinberg, *Section 29(b) of the Securities Exchange Act of 1934: A Viable Remedy Awakened*, 48 GEO. WASH. L. REV. 1 (1979).

51. *Harris v. Palm Springs Alpine Estates, Inc.*, 329 F.2d 909 (9th Cir. 1964).

52. SHELDON M. JAFFE, *BROKER-DEALERS AND SECURITIES MARKETS: A GUIDE TO THE REGULATORY PROCESS* § 2.05, at 24 (1977) (citing *Hayden v. Walston & Co., Inc.*, 528 F.2d 901, 902 (9th Cir. 1975)).

remain subject to both the antifraud provisions of the federal securities laws⁵³ and to the Commission's broker-dealer regulations.⁵⁴

B. The "Finder" Phenomenon

The definition of "broker" in section 3(a)(4)⁵⁵ would seem to encompass finders, because they initiate securities transactions between buyers and sellers and because traditionally the Commission has broadly interpreted the phrase "effecting transactions."⁵⁶ The widespread occurrence of the finder phenomenon, however, testifies to both the perceived validity and the demonstrated utility of this de facto exception from broker-dealer registration:

In numerical terms, perhaps more persons rely upon [the finder's] exception than on any other provision in the 1934 Act. It is the small businessman's exclusion and the basis upon which innumerable local "consultants" perform financial services for friends and associates without complying with the formal registration, record keeping [sic], and other requirements imposed upon brokers by § 15 of the 1934 Act. The strict definition of a "finder" is relatively narrow and would probably exclude, if tested, the majority who claim it as protection. . . .

. . . .

Accordingly, in practice if not in theory, a distinction appears to have developed between the professional masking as an amateur and the amateur inadvertently trespassing into the area of the professional. The registration requirements are only intermittantly [sic] enforced against the amateur but are strictly enforced against the professionals or those who engage in the securities business on a regular basis.⁵⁷

53. Securities Act of 1933, Pub. L. No. 73-22, § 17(a), 48 Stat. 74, 84-85 (1933) (current version at 15 U.S.C. § 77q(a) (1988)); Exchange Act, §§ 10(b), 15(c), 15 U.S.C. §§ 78j(b), 78o(c) (1988); Rules 10b-5, 15c1-2, 17 C.F.R. §§ 240.10b-5, 15c1-2 (1991).

54. Exchange Act, § 3(a)(48), 15 U.S.C. § 78c(a)(48) (1988) (stating that definition of "registered broker or dealer" includes all broker-dealers required to register even if they have not done so). Some of the statutory and regulatory provisions described above as applicable to registered broker-dealers are actually applicable by their own terms to unregistered broker-dealers as well. See, e.g., Exchange Act, §§ 15(b)(4), (6), 15 U.S.C. §§ 78o(b)(4), (6); Rules 15c3-1, 15c3-3, 17a-3, 17a-4, 17a-5, 17 C.F.R. §§ 240.15c3-1, 15c3-3, 17a-3, 17a-4, 17a-5 (1991).

55. 15 U.S.C. § 78c(a)(4) (1988).

56. "To 'effect' a transaction includes 'any participation in a transaction whether as principal, agent, or both.'" WEISS, *supra* note 4, at 106 n.12 (quoting Exchange Act Release No. 605 (Apr. 17, 1936) (defining "effecting transactions" in connection with Section 11(d)(2) of the Exchange Act, 15 U.S.C. § 78k(d)(2))).

57. JAFFE, *supra* note 52, § 2.04, at 21-22.

Even though finders fit within the literal language of section 15(a)(1),⁵⁸ the staff's practice of not requiring certain finders to register as broker-dealers releases them from all the attendant regulatory requirements.⁵⁹

This result may not always comport with sound public policy. In fact, Congress, albeit in the underwriting context, has noted that there are a number of problems inherent in not requiring finders to register.⁶⁰ Defining what it means to "effect" transactions, however, has proven to be difficult. For example, the leading commentator on federal securities regulation stated that "[a]lthough a finder may 'induce the purchase or sale of' a security within the meaning of § 15(a), he is not normally a 'broker' because he effects no transactions."⁶¹ This statement, nevertheless, begs the ultimate question of what it means to effect a transaction in securities, a theoretical question whose practical implications become clearer in the light of actual cases.

III. FINDING INVESTORS FOR BROKER-DEALERS

It is only natural that an important manifestation of the finder phenomenon would be the activities of persons who find investors for registered broker-dealers. As commissioned salesmen, broker-dealers understandably have a continual need for new customers. Persons willing to locate prospective customers for a broker-dealer are of great value, especially if the broker-dealer does not have to incur the expense of employing those persons, registering them as associated persons with the broker-dealer's SRO, and supervising their activities. Yet, this type of arrangement is not without its perils.⁶²

58. 15 U.S.C. § 78o(a)(1) (1988).

59. One commentator has identified four factors, or "badges," of broker-dealer activity that the staff considers when applying the broker-dealer registration requirements to finders. These factors include: (i) involvement in negotiations; (ii) discussing details concerning securities, or making recommendations; (iii) transaction-based compensation; and (iv) previous involvement in the sale of securities. DAVID A. LIPTON, *supra* note 20, § 1.04[3][6][ii][A].

60. S. Rep. No. 1455, 73d Cong., 2d Sess. 115-16 (1934). The Senate Committee on Banking and Currency reported that "the institution of 'finder's' fees [for recommending investment banking transactions] is undesirable for the reason that it encourages activities looking to the flotation of securities regardless of their soundness. It also involves additional expense, which is ultimately passed on to the investing public." *Id.*

61. LOUIS LOSS, *SECURITIES REGULATION* 1299 (2d ed. 1961). Recently, however, Loss has qualified the definition of a finder in an apparent recognition of the potentially detrimental effect of the finder phenomenon on the scope of the broker-dealer registration requirements. Loss noted that "although a *pure* finder may 'induce the purchase or sale of' a security within the meaning of § 15(a), he is not normally a broker because he effects no transactions. *He merely brings buyer and seller together.*" LOUIS LOSS, *FUNDAMENTALS OF SECURITIES REGULATION* 609 (1988) (emphasis added).

62. See WEISS, *supra* note 4, at 7. Weiss recognized the following difficulties:

A. Licensed Professionals

Despite these potential problems, the staff has taken no-action positions regarding the activities of accountants⁶³ and insurance agents⁶⁴ who referred their clients to registered broker-dealers.⁶⁵ Generally, the accountants or insurance agents provided information to their clients concerning only the services offered by the broker-dealers and not the merits of any particular security.⁶⁶ Sometimes, additional activities were performed, such as providing administrative services to the broker-dealer,⁶⁷ collecting from the clients financial information prescribed by the broker-dealer,⁶⁸ and arranging meetings between the clients and the broker-dealer.⁶⁹

These arrangements were to continue indefinitely and were not one-time occurrences. As a result, they would constitute part of the "business" of the accountants and insurance agents. Relying principally on the limited nature

Problems would . . . arise in connection with certain practices of some broker-dealers . . . if these broker-dealers should circulate invitations to attorneys and accountants, upon the inducement of a commission, to sell to their clients the securities being offered by such broker-dealers. Apart from questions as to violation of anti-fraud provisions of the federal securities laws, acceptance of these proposals would result in the accountants and attorneys becoming engaged in the business of effecting transactions in securities for the account of others, and thereby becoming brokers.

Id. (footnote omitted). See generally NICHOLAS WOLFSON ET AL., REGULATION OF BROKERS, DEALERS, AND SECURITIES MARKETS, § 1.09 (1977).

63. See Biscotti & Co. Certified Public Accountants, P.C., SEC No-Action Letter, 1985 SEC No-Act. LEXIS 2924 (Oct. 28, 1985); Redmond Assocs., SEC No-Action Letter, 1985 SEC No-Act. LEXIS 1589 (Dec. 11, 1984).

64. Colonial Equities Corp., SEC No-Action Letter, 1988 SEC No-Act. LEXIS 862 (June 28, 1988) (also addressing real estate agency); M Financial, SEC No-Action Letter, 1988 SEC No-Act. LEXIS 786 (June 14, 1988).

65. The staff recently took a similar no-action position regarding an investment adviser. The adviser proposed to refer its clients to a registered broker-dealer for execution of their securities transactions at the broker-dealer's usual commission rates or mark-ups. The broker-dealer would remit a portion of these commissions or mark-ups to a trust fund established for the exclusive benefit of the clients. If the clients' employers had retained the adviser to provide services to the clients and had treated the value of these services as additional income to the clients for purposes of federal income tax, the employers would offset the clients' monies in the trust fund against this additional income, thereby reducing the clients' federal income tax liability. See Asset Management Group, SEC No-Action Letter, 1989 SEC No-Act. LEXIS 1016 (Sept. 20, 1989).

66. In one case, however, the accountants proposed to act as purchaser representatives in an offering of securities exempt from Securities Act registration under Regulation D, 17 C.F.R. §§ 230.501-508 (1991), and to become registered representatives of a broker-dealer for the purpose of placing orders for mutual fund shares. See Biscotti & Co., SEC No-Action Letter, *supra* note 63.

67. See M Financial, SEC No-Action Letter, *supra* note 64.

68. See Colonial Equities, SEC No-Action Letter, *supra* note 64.

69. *Id.*

of the activities permitted under the arrangements,⁷⁰ and to a somewhat lesser extent on the nature of the compensation received by the finders, however, the staff did not deem participation in these arrangements to constitute the business of effecting securities transactions. In one case, accountants represented that the ethical rules of the American Institute of Certified Public Accountants at the time forbade receipt of contingency fees or commissions.⁷¹ Consequently, the accountants would rebate to their clients any commissions received. Under one particularly elaborate compensation scheme, the finders received a one-time, flat fee of \$500 for properly identifying a potential customer sought by the broker-dealer, and an additional one-time, flat fee of \$1000 for arranging a meeting between the broker-dealer and the potential customer.⁷² While creative, these fees do not resemble or function as a surrogate for brokerage commissions.

In another case, counsel disclosed that the finders would receive one-time fees based on the size of retirement accounts opened with the broker-dealer.⁷³ The staff also has permitted compensation to be based, in part, on aggregate insurance premium revenues, including commissions on transac-

70. In one case, employees of insurance agencies and a realty company would ask their clients to complete questionnaires that had been prepared by the broker-dealer. They would inform the clients that the broker-dealer would use the biographical and financial information from the questionnaires to decide whether to contact them regarding the possible purchase of certain limited partnership interests. In addition, the employees would review the questionnaires for completeness and send completed questionnaires to the broker-dealer. The broker-dealer might also ask the insurance agency employees to provide introductions to their clients, either in person or over the telephone. None of the employees, however, could make any statements to their clients about the nature or advisability of investing in the limited partnership, nor could they handle any funds or securities. Counsel represented that the broker-dealer would closely monitor the employees' activities, and that violation of restrictions placed on the employees' permissible activities would cause the broker-dealer to terminate its arrangements with these finders. *Id.*

71. Biscotti & Co., SEC No-Action Letter, *supra* note 63.

72. Colonial Equities, SEC No-Action Letter, *supra* note 64. Although these fees were high, counsel's justification for them was based on the broker-dealer's predictions regarding the large financial investment that it was seeking, and expecting, from potential customers. These fees could be adjusted by the broker-dealer, as to all finders participating in the arrangement, once in each twelve-month period, and only prospectively. The fees would not vary with brokerage commissions earned on investments made by potential customers. Indeed, counsel's initial proposal, which the final response indicates was rejected by the staff, called for the finders to receive a percentage of these net brokerage commissions. *Id.*

Although potentially expansive in its application, the approach permitted by the staff in this case actually may be of limited utility. A supplemental response from the staff indicated that the finders' activities raised might constitute "general solicitation" impermissible under Regulation D, 17 C.F.R. §§ 230.501-508 (1991). Colonial Equities Corp., SEC No-Action Letter, 1988 SEC No-Act. LEXIS 1291 (Sept. 2, 1988).

73. Redmond Associates, SEC No-Action Letter, *supra* note 63 (representing that the fees would bear no relation to commissions earned on securities transactions in the accounts or to subsequent investments).

tions in insurance securities.⁷⁴ In reality, these other types of payments are compensation based on the outcome of securities transactions. They provide a powerful incentive for finders to conduct sales efforts exceeding the scope of their purportedly limited activities, and thus implicate the policies supporting broker-dealer registration. In other words, persons regularly compensated for their securities activities as if they were broker-dealers—by receiving a commission—are likely to engage in the same business practices as broker-dealers and should be regulated as such.⁷⁵ The staff's no-action positions in these cases appear to depart from what would be a sound general rule, in terms of both administrative practice and public policy: requiring registration of persons who receive transaction-based compensation for their securities-related activities.⁷⁶

B. Other Non-Brokerage Businesses

The staff also has taken no-action positions on broker-dealer registration regarding the activities of other types of businesses that proposed to refer their customers to broker-dealers,⁷⁷ although on at least two occasions a no-action request of this type was denied.⁷⁸ The requests which met with the staff's approval involved businesses that would provide their customers with general information about broker-dealers and the services that they offer.

74. M Financial, SEC No-Action Letter, *supra* note 64.

75. While receipt of transaction-based compensation should be a sufficient condition to define the recipient as a broker, it should not be necessary in all cases. A person's activities as an intermediary in connection with securities transactions could place that person within the definition of broker, regardless of the nature of the person's compensation. *See infra* notes 162-209 and accompanying text.

76. For example, in other areas, the Commission has favored a policy of functional regulation, such that an entity is regulated not according to its form, but according to its activities. *E.g., Role of Financial Institutions: Hearings on H.R. 2557 Before the Subcomm. on Telecommunications and Finance of the House Comm. on Energy and Commerce, 100th Cong., 1st Sess. 48, 54 (1987)* (statement of David S. Ruder, Chairman, Securities and Exchange Commission) ("[L]egislation is needed in order to apply functional regulation to the financial services industry. If banks are to engage in securities activities, they should be subject to the same regulations as are all other entities engaged in those activities.").

77. Original Fin. Info. Ctrs. of Am., Inc., SEC No-Action Letter, 1987 SEC No-Act. LEXIS 2503 (Aug. 31, 1987) (proposing to open "Financial Information Centers" in shopping malls to provide advertising formats for different types of financial products and services); Financial Charters and Acquisitions, Inc., SEC No-Action Letter, 1984 SEC No-Act. LEXIS 2821 (Nov. 25, 1984) (proposing to provide consulting services to savings and loan associations).

78. John M. McGivney Securities, Inc., SEC No-Action Letter, 1985 SEC No-Act. LEXIS 2159 (May 20, 1985) (proposing that broker-dealer would make payments to a non-securities firm based on a percentage of commissions or transaction-based compensation); George T. Baylor, SEC No-Action Letter, 1971 SEC No-Act. LEXIS 3245 (Sept. 5, 1971) (proposing to establish a restaurant containing telephone lines to brokerage houses).

For example, one business proposed to make available free information about providers of financial services, including mutual funds and broker-dealers.⁷⁹ Compensation to the business from these advertisers was limited to fees based on their rental of space at each location and on their use of electronic message boards.⁸⁰ There also would be direct telephone lines to broker-dealers, an electronic ticker-tape reporting current stock prices, the Dow Jones news service, and a stock-quotation machine.⁸¹ Each location would be staffed only by employees of the business, who would not receive transaction-based compensation, dispense financial advice, or aid consumers in selecting financial services. Compensation received by both the business and its employees was strictly limited, and neither the business nor its employees would consummate securities transactions or hold customers' funds.⁸²

The staff's negative responses confirm the importance of the remuneration paid to providers of information about broker-dealers and the latter's services. In 1971, a restaurant proposed to display transactions taking place on the New York Stock Exchange (NYSE) and the American Stock Exchange (Amex), in addition to offering telephone lines to various broker-dealers.⁸³ Without promoting a particular firm or security, the restaurant would receive a fee from those broker-dealers.⁸⁴ The staff informed the restaurant that those activities would require broker-dealer registration.⁸⁵ This scenario closely resembles one to which the staff did not object in 1987,⁸⁶ a response which appears to represent a softening of the staff's position regarding these arrangements.⁸⁷ Moreover, the 1971 request did not expressly exclude a share of commissions or other transaction-based payments from the remuneration to be received by the restaurant, as did the 1987 request. The staff's responses are consistent, therefore, with another denial of a no-action position in this area, in which a broker-dealer proposed to pay a "finder's fee" based on a percentage of brokerage commissions to a non-

79. Original Fin. Info. Ctrs., SEC No-Action Letter, *supra* note 77.

80. *Id.*

81. *Id.*

82. *Id.* In its response, the staff included a warning about the applicability of the antifraud provisions of the federal securities laws to the proposal. *See supra* note 53.

83. George T. Baylor, SEC No-Action Letter, *supra* note 78.

84. *Id.*

85. *Id.*

86. *See* Original Fin. Info. Ctrs., SEC No-Action Letter, *supra* note 77.

87. The information provided in the 1971 scenario apparently comprised reports of actual securities transactions, rather than merely quotations, as in the 1987 situation. *See* George T. Baylor, SEC No-Action Letter, *supra* note 78; Original Fin. Info. Ctrs., SEC No-Action Letter, *supra* note 77. In the presence of direct telephone lines to broker-dealers, however, both types of information can be viewed as incentives to trade.

securities firm performing unspecified activities.⁸⁸ The staff flatly stated that registration would be required of any person receiving a percentage of commissions or other transaction-based compensation.⁸⁹

C. Depository Institution Networking

A "networking" arrangement is a specialized type of program in which non-brokerage businesses refer their customers to broker-dealers. The arrangement is generally between a depository institution, such as a bank or savings and loan association, and a registered broker-dealer. The broker-dealer usually maintains a physical presence on the premises of the depository institution, and the latter's customers are encouraged to use the services of that broker-dealer in connection with their securities transactions. In return, the depository institution receives a portion of the commissions earned by the broker-dealer on those transactions.

The first networking arrangement was approved by the Commission itself in 1982.⁹⁰ It has served as a model for the plethora of letters that the staff has issued in this area. The Commission considered a registered broker-dealer's proposal to offer brokerage services on the premises of savings and loan associations. The broker-dealer would function as an "introducing broker," with funds and securities flowing directly between its clearing broker and the customers.⁹¹ The broker-dealer would not engage in any underwriting or dealing activities, and it would not recommend to customers the se-

88. McGivney Securities, SEC No-Action Letter, *supra* note 78.

89. *Id.* But see Financial Charters and Acquisitions, SEC No-Action Letter, *supra* note 77. In that case, a business proposed to introduce a broker-dealer to financial institutions potentially interested in the broker-dealer's hedging strategies, without describing those strategies or participating in negotiations between the broker-dealer and the financial institutions. The business could receive alternative fees, one of which was equal to one-third of the gross commissions realized by the broker-dealer from accounts opened by the financial institutions. The fee was payable, however, only from commissions on trades in exempt securities, as defined in section 3(a)(12) of the Exchange Act, 15 U.S.C. § 78c(a)(12) (1988), or in instruments excluded by section 15(a)(1). *Id.* The latter instruments include commercial paper, bankers' acceptances, and commercial bills. See 15 U.S.C. § 78o(a)(1) (1988).

90. Savings Ass'n Inv. Sec., SEC No-Action Letter, [1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,228 (July 8, 1982).

91. An introducing broker may be defined as follows:

A broker-dealer that, under a contractual arrangement with a carrying or clearing broker-dealer, transmits funds, securities and orders of customers to the clearing firm which executes the orders and maintains custody of the customer funds and securities. The clearing firms' contractual responsibilities also include the proper disposition of customer funds and securities after trade date, the transfer to the customer of funds and securities after settlement and the maintenance of certain records.

Division of Market Regulation, Securities and Exchange Commission, *The October 1987 Market Break* I-3 (Feb. 1988). For a technical discussion of the relationship between introducing and clearing or carrying brokers, see William J. Fitzpatrick & Ronald T. Carman, *An Analysis*

curities of any issuers that had lending relationships with the savings and loan associations. The broker-dealer would conduct its securities business in areas segregated from those where the business of the savings and loan association occurred. The broker-dealer would prepare and approve all advertising, promotional material, customer application forms, and confirmations. Monthly statements would make clear that securities services were being provided by the broker-dealer and not the savings and loan associations. Finally, the broker-dealer would develop a compliance manual for the use of the savings and loan associations in fulfilling their responsibilities under the arrangement.⁹²

Personnel of the savings and loan associations would become registered representatives of the broker-dealer and dual employees of the broker-dealer and the savings and loan associations, receiving a salary instead of commissions.⁹³ The activities of unregistered employees were limited to distributing literature to customers and other persons. The savings and loan associations would be deemed associated persons of the broker-dealer under section 3(a)(18) of the Exchange Act,⁹⁴ and they would receive one-half of the broker-dealer's commissions from securities transactions initiated on their premises.⁹⁵

The Commission was aware of the ground-breaking nature of its approval of this arrangement, which expressly was conditioned on "strict adherence" to the representations made in counsel's letter.⁹⁶ The no-action letter emphasized the role played by the registered broker-dealer and noted that all personnel of the savings and loan association engaged in securities activities would be subject to the Commission's regulations and the SROs' rules. The letter did not agree with counsel's opinion that participating savings and loan associations would not be brokers within the meaning of section

of the Business and Legal Relationship Between Introducing and Carrying Brokers, 40 BUS. LAW. 47 (1984).

92. Savings Ass'n Inv. Sec., SEC No-Action Letter, *supra* note 90.

93. *Id.* Personnel of the savings and loan associations would be trained, supervised, and controlled by the broker-dealer, and they could be fired or suspended from their employment with the savings and loan associations if they were barred or suspended from association with the broker-dealer.

94. 15 U.S.C. § 78c(a)(18) (1988).

95. Savings Ass'n Inv. Sec., SEC No-Action Letter, *supra* note 90. Further conditions were imposed on the savings and loans associations. The broker-dealer's records on the premises of the savings and loan associations were required to be available for inspection by the Commission. In advertising, the savings and loan associations could be mentioned only as the locations at which the broker-dealer was offering its services, and these references could not be prominent. In addition, the savings and loan associations could not handle customers' funds or securities. *Id.*

96. By their very nature, all no-action positions are limited to their facts. *See supra* note 15.

3(a)(4).⁹⁷ The Commission warned that there were “substantial arguments to the contrary” based on the “structural and financial relationship” between the parties.⁹⁸

This caution was appropriate. Even though counsel argued that the savings and loan associations would not be engaged in the business of effecting securities transactions by referring their customers and others on their premises to the broker-dealer in return for a share of the commissions on resulting securities transactions, it was clear that they would be acting as finders for the registered broker-dealer. On the other hand, registration would result in little more protection than that afforded by the presence of the registered broker-dealer and would have been impractical in any case, due to the inability of the savings and loan associations to comply with the Commission’s net capital rule⁹⁹ because of their mortgage loan portfolios. The impetus for the no-action letter appears to have been the increasing involvement of banks in the securities business, and the concomitant need for savings and loan associations (which fall outside the scope of section 3(a)(6)¹⁰⁰ and are potentially within the definition of broker) to compete with banks in that business. Thus, unlike other finders, the participating savings and loan associations were allowed to receive commissions without becoming registered broker-dealers.¹⁰¹

The current staff position on depository institution networking arrangements has changed somewhat, as an examination of a representative recent letter shows.¹⁰² Credit unions are now permitted to network with broker-dealers. Brokerage services may be provided off the premises of the depository institution and the use of joint employees appears to have become infrequent. The staff now requires an affirmative representation that the broker-dealer will control, properly supervise, and be responsible for the brokerage activities of registered representatives participating in the networking arrangement.¹⁰³ The broker-dealer may now provide commercially available research materials and investment information to customers on the premises of the depository institution.¹⁰⁴

97. 15 U.S.C. § 78c(a)(4) (1988).

98. Savings Ass’n Inv. Sec., SEC No-Action Letter, *supra* note 90.

99. Rule 15c3-1, 17 C.F.R. § 240.15c3-1 (1991).

100. 15 U.S.C. § 78c(a)(6) (1988).

101. Savings Ass’n Inv. Sec., SEC No-Action Letter, *supra* note 90.

102. Collateral Fin. Brokerage, Inc., SEC No-Action Letter, 1989 SEC No-Act. LEXIS 743 (June 7, 1989).

103. *Id.*

104. *See, e.g.*, Moore & Schley, Cameron & Co., SEC No-Action Letter, 1989 SEC No-Act. LEXIS 1282 (May 19, 1989).

As the staff has acquired experience with the operation of these arrangements, other conditions have become more specific. The employees of the depository institutions may only perform clerical or ministerial duties. These include helping customers fill out account forms, reviewing the forms for completeness, and forwarding them to the broker-dealer at the customers' request. The employees may distribute information about the broker-dealer, but they are prohibited from recommending securities, providing investment advice, or handling any questions requiring familiarity with the securities industry or the exercise of judgment. Depository institution employees continue to be prohibited from accepting or transmitting orders or funds; however, they are permitted to make electronic transfers of funds between customers' accounts with the depository institutions and their accounts with the broker dealer.¹⁰⁵

The broker-dealer and the depository institutions now must take positive steps to ensure adherence to compliance manuals governing the conduct of the parties to the arrangement. The depository institutions may prepare advertising and informational and promotional materials, as long as the broker-dealer approves them before distribution. It is no longer necessary for these materials to describe the depository institution solely as the place where brokerage services are provided. Although a complete analysis of the no-action letters concerning depository institution networking is beyond the scope of this article, a brief treatment of the topic has been included to demonstrate that the rationale for those letters is the same as that underlying the finders' no-action letters.¹⁰⁶

D. Common-Interest Groups

Other business or social organizations, such as clubs or trade associations, also can serve as a fertile source of referrals to broker-dealers. The relatively close ties among members, the ease of disseminating information to them, and the likelihood of members being receptive to the organization's recommendations apparently have provided sufficient incentive for broker-dealers to enlist the aid of these groups. The broker-dealer obtains brokerage business from group members in return for a fee, and sometimes for a share of commissions. These requests have not always found favor with the staff.¹⁰⁷ For purposes of classification, this article refers to such organizations as common-interest groups.

105. *Id.*

106. *See supra* notes 90-104 and accompanying text.

107. *See infra* note 117 and accompanying text.

1. Thrift Institution Leagues

Thrift institution league arrangements closely resemble the depository institution networking arrangements discussed above.¹⁰⁸ Two leagues of state savings and loan associations received no-action positions allowing them to promote the discount brokerage services of registered broker-dealers to league members.¹⁰⁹ All purchases or sales of securities, however, were to be transacted by the broker-dealers directly with customers of league members. Joint employees of the leagues and the broker-dealers would distribute literature to league members, familiarize them with the benefits of participation, and encourage them to conclude agreements with the broker-dealers, to which the leagues would not be parties. The broker-dealers would review and approve all advertising. These joint employees would be supervised by the broker-dealers but compensated by the leagues. Neither the joint employees nor the leagues would have dealings with the securities customers or any involvement in securities transactions. The joint employees would not receive any commissions or other compensation relating to the brokerage business provided to the broker-dealers by customers of the leagues' members. Instead, the leagues themselves would receive a percentage of the gross brokerage commissions.¹¹⁰

The payment of commissions raises an apparent contradiction. Networking no-action letters have permitted savings and loan associations and credit unions to receive commissions. The staff has noted that these institutions are depository institutions, like banks, which are statutorily excluded from the definition of broker.¹¹¹ A league of depository institutions is not itself a depository institution. The staff has resolved this contradiction, however, in a recent no-action letter concerning a state league of credit unions.¹¹² The league proposed to perform activities similar to those in the earlier letters, and counsel's initial letter stated that the broker-dealer would give a percentage of gross commissions to the league.¹¹³

The staff's response indicates that this proposal was rejected. The response does not allow for commissions, but instead, sanctions other pay-

108. See *supra* notes 90-106 and accompanying text.

109. BSLA Sec., Inc., SEC No-Action Letter, 1984 SEC No-Act. LEXIS 2448 (Feb. 27, 1984); GIT Inv. Servs., Inc., SEC No-Action Letter, 1983 SEC No-Act. LEXIS 2888 (Aug. 30, 1983).

110. *Id.*

111. See *supra* note 7 and accompanying text.

112. Moore & Schley, Cameron & Co., SEC No-Action Letter, *supra* note 104 (proposing to advise league members of the availability of a registered broker-dealer's services to customers of league members).

113. *Id.*

ments by the broker-dealer to the league.¹¹⁴ In the first year of the arrangement the broker-dealer pays a flat monthly fee, not to exceed \$300, in return for the league's administrative services. This fee may be increased in later years as administrative services rise in proportion to the number of participating league members.¹¹⁵ When considered with the Colonial Equities no-action letter discussed above,¹¹⁶ this letter shows the extreme depths to which the staff may probe in order to determine whether a finder will receive, directly or indirectly, any transaction-based compensation, regardless of how the compensation is denominated.¹¹⁷

2. Nonprofit Organizations

Nonprofit organizations occasionally have proposed to make their members aware of the services available from registered broker-dealers.¹¹⁸ The organizations propose to arrange for meetings, make announcements in their publications, provide mailing lists of their members, assist in the preparation and dissemination of informational materials, and allow their logos to appear on those materials. They refer all inquiries from their members to broker-dealers and avoid handling their members' funds or securities, accepting orders, and recommending securities.¹¹⁹

At first, these no-action positions appear justified, on the grounds that these activities are more informational than transactional in nature. The compensation received by these organizations, however, evidences a departure from the staff's "no commission" rule.¹²⁰ Allowable compensation has included twenty percent of the broker-dealer's advisory fees (one-half of one-

114. *Id.*

115. *Id.* The broker-dealer may pay a supplemental flat monthly fee for each league member that joins the program, although this fee will not vary with the size of league membership, the volume of securities transactions from its customers, or the amount of commissions from those transactions. The supplemental fee cannot be modified, and it will not be greater than \$100. *Id.*

116. *Supra* notes 60, 64-66, 68 and accompanying text.

117. Moore & Schley, Cameron & Co., SEC No-Action Letter, *supra* note 104. One recent commentator seemingly has glossed over this important point. See Crespi, *supra* note 14, at 345-46 ("As a general matter, a person may find prospective securities purchasers and introduce them to prospective sellers, introduce prospective purchasers to prospective lenders to finance securities transactions, act as a consultant to sellers regarding the terms of a securities sale, and receive transaction-based compensation for those services, without being required to register.")

118. Security Pacific Brokers, Inc., SEC No-Action Letter, 1985 SEC No-Act. LEXIS 1961 (Mar. 5, 1985); Ewing Capital, Inc., SEC No-Action Letter, 1985 SEC No-Act. LEXIS 1597 (Jan. 25, 1985); National School Bds. Ass'n, SEC No-Action Letter, 1984 SEC No-Act. LEXIS 1797 (Feb. 18, 1984).

119. See *supra* note 117.

120. See *supra* note 75.

percent of assets under management) from accounts opened by members¹²¹ and an outright percentage of commissions earned on members' brokerage transactions.¹²² There appears to be no reason grounded in securities law for distinguishing these organizations from other groups, such as thrift institution leagues, that perform the same activities. The staff appears to have been inordinately influenced by the nonprofit status of these organizations.¹²³

3. Other Organizations

Two other types of common-interest groups deserve mention: service organizations¹²⁴ and affinity groups.¹²⁵ These groups have been good sources of new retail customers for broker-dealers. They have been permitted to perform informational and promotional services similar to those already discussed.¹²⁶ In fact, one set of affinity groups was permitted to send new account application forms to their members, which could be returned by direct mail to the broker-dealer.¹²⁷ Once again, despite the fact that these organizations and groups received a share of the commissions generated by members' securities transactions, the staff took no-action positions.¹²⁸

The no-action letters permitting common-interest groups to receive transaction-based compensation for acting as finders may represent an expansion of the networking concept beyond the scope of its original application to depository institutions.¹²⁹ While it is sometimes possible to glean the staff's legal views from the way in which it exercises its prosecutorial discretion, the staff's silence on this point may be susceptible to differing interpretations.

E. Related Commission Decisions

The Commission's own decisions concerning finders are somewhat more enlightening. First, it is worth noting that registered broker-dealers are ac-

121. National School Bds. Ass'n, SEC No-Action Letter, *supra* note 118.

122. Security Pacific Brokers, SEC No-Action Letter, *supra* note 118; Ewing Capital, SEC No-Action Letter, *supra* note 118.

123. These nonprofit organizations included school districts and educational and charitable organizations.

124. *See, e.g.*, Security Pacific Brokers, Inc., SEC No-Action Letter, 1985 SEC No-Act. LEXIS 2700 (June 20, 1985).

125. *See, e.g.*, Merrill Lynch, Pierce, Fenner & Smith, Inc., SEC No-Action Letter, 1987 SEC No-Act. LEXIS 2509 (June 9, 1987).

126. *See supra* notes 108, 123 and accompanying text.

127. Merrill Lynch, SEC No-Action Letter, *supra* note 125.

128. *See supra* notes 124-25.

129. *See supra* notes 90-105 and accompanying text.

countable for "all violations of the federal securities laws committed by any person employed by [the broker-dealer] in any capacity; or by any other individual who effects or induces transactions in securities for the registrant" ¹³⁰ The NASD has the authority to discipline its members both for violations of its own rules and for violations of the statutory and regulatory provisions of the federal securities laws. ¹³¹ Furthermore, the Commission has the authority to review those sanctions on appeal. ¹³²

One recent case involved associated persons of NASD member firms who engaged in private securities transactions without giving the required prior written notification to their employers. ¹³³ In that case, the Commission affirmed the NASD's sanctions when it rejected the argument that an associated person did not effect the transactions in question. The associated person argued that he merely referred the firm's customers to the syndicator of certain limited partnerships in return for finder's fees. ¹³⁴ The Commission noted, however, that this associated person repeatedly recommended that his clients invest in these limited partnerships, gave them the syndicator's name if they expressed interest, and actually received commissions from the syndicator after some of the clients purchased limited partnership interests. ¹³⁵ The Commission did not discuss whether the broker-dealer registration requirements would apply to any of the associated persons if they were operating outside the scope of their employment with the NASD member. ¹³⁶ The Commission's and NASD's use of these findings, however, could

130. WEISS, *supra* note 4, at 34 (footnotes omitted).

131. NASD By-Laws, Art. XIV, § 1, *reprinted in* NASD Manual (CCH) ¶ 1271 (Apr. 1991).

132. 15 U.S.C. § 78s(d)-(f) (1988).

133. Allen S. Klosowski, Exchange Act Release No. 25,467, 40 SEC Docket 783 (Mar. 15, 1988).

The NASD prohibits any person associated with an NASD member firm from participating in a securities transaction outside the scope of the person's employment with the firm unless, among other things, the person gives the firm prior written notification describing the proposed transaction in detail, including the compensation that the person anticipates receiving. NASD Rules of Fair Practice, Art. III, § 40(a)-(b), *reprinted in* NASD Manual (CCH) ¶ 2200 (July 1988); *see also* SEC v. Ridenour, 913 F.2d 515 (8th Cir. 1990) (holding that an account executive in the bond department of a brokerage firm violated broker-dealer registration requirements, because the high level of his activity involving securities transactions exceeded that of merely an active investor, and because he maintained regular clients for private bond transactions negotiated from the firm's offices but for his own account). The Commission also instituted administrative proceedings against Ridenour, in which he was barred from association with any broker or dealer. Robert L. Ridenour, Exchange Act Release No. 29,184, 48 SEC Docket 1345 (May 9, 1991).

134. Allen S. Klosowski, *supra* note 133.

135. *Id.*

136. *Id.*; *see also* The Cambridge Group, Inc., Exchange Act Release No. 29,795, 49 SEC Docket 1810 (Oct. 8, 1991).

help turn aside a finder's argument that referring potential purchasers of securities in return for commissions does not amount to effecting transactions in securities.¹³⁷

Another way to glean the Commission's attitude toward finders is to review cases in which the Commission bars persons from associating with registered broker-dealers. In at least two decisions, the Commission barred persons from such association, a sanction that effectively prevented those persons from engaging in the securities business, while at the same time permitting them to act as finders.¹³⁸ On an earlier occasion, the Commission permitted, over the staff's public objections, the continued membership in the NASD of a brokerage firm employing a person who had caused the revocation of another broker-dealer's registration and the expulsion of that broker-dealer from the NASD for antifraud violations.¹³⁹ Under the managing partner's supervision, the person's duties would consist of finding companies requiring financial advice that the firm might be able to provide, making the initial contacts, and turning over prospects to the managing partner for handling.¹⁴⁰

137. The staff reiterated its own views in a recent letter responding to an inquiry from a branch manager of a registered broker-dealer, who proposed to act in the United States as a finder for unregistered foreign broker-dealers. Richard D. VandenBerg, SEC No-Action Letter, 1990 SEC No-Act. LEXIS 1221 (Sept. 5, 1990). The branch manager proposed to hold seminars, disseminate information, and refer potential customers to the foreign broker-dealers. The staff warned that if this finder's activities exceeded the scope of his duties for the registered broker-dealer, he himself could be deemed to be an unregistered broker-dealer. The staff added that the finder's activities would result in the foreign broker-dealers being required to register as well.

138. Steven R. Tatusko, Exchange Act Release No. 21,849, 32 SEC Docket 858 (Mar. 13, 1985) (finding that respondent could continue association with current employer if he acted only as a finder of other broker-dealers that would attempt, through private placements, to sell interests in enterprises in which the employer was the general partner); IMH Sec. Corp., Exchange Act Release No. 10,543, 3 SEC Docket 208 (Dec. 7, 1973) (allowing respondent to act as "go-between, middleman or finder" between issuers and underwriters of exempt securities).

139. Robert Edelstein, Exchange Act Release No. 8159, 1967 SEC LEXIS 547, 548 (Sept. 18, 1967). Under section 15A(g)(2) of the Exchange Act, 15 U.S.C. § 78o-3(g)(2) (1988), the NASD may "deny membership to any registered [broker-dealer], and bar from [association] with a member any person, . . . subject to a statutory disqualification." Also, the NASD is required to notify the Commission prior to admitting to membership any registered broker-dealer, or prior to permitting to become associated with a member any person, subject to a statutory disqualification. The term "statutory disqualification" is defined in section 3(a)(39) of the Exchange Act, 15 U.S.C. § 78c(a)(39)(1988).

140. Robert Edelstein, Exchange Act Release, *supra* note 139. In Van Alstyne, Noel & Co., 43 S.E.C. 1080 (1969), the Commission imposed sanctions on a broker-dealer with an associated person who received a retainer fee for finding underwriting opportunities for the broker-dealer. The person had committed willful violations of the federal securities laws prior to association with the broker-dealer, and he was permanently enjoined from committing other violations during association. The broker-dealer had not amended its registration application with the Commission to disclose this person's identity and disciplinary history. *Id.* The sanc-

It is possible to infer that the Commission did not consider these activities to be within the scope of effecting securities transactions and, therefore, considered them properly outside the scope of the sanctions in these cases. There was no discussion, however, in any of these cases of whether the permitted activities themselves would require broker-dealer registration. Moreover, any perceived leniency in the application of the broker-dealer registration requirements to these finders is dispelled by the fact that the activities were performed by persons employed by, and under the supervision of, registered broker-dealers. One of the chief risks incurred in allowing finders to remain unregistered is the absence of this supervision and control.

In one recent case, *Traiger Energy Investments*, however, the Commission addressed the status of finders more directly, though still in the context of association with a registered broker-dealer.¹⁴¹ An NASD member firm, which was an underwriter for a private offering of oil and gas limited partnerships, paid finder's fees to persons who referred to the firm other persons who ultimately purchased the limited partnership interests being offered. The Commission set aside the NASD's sanctions against the member firm for failing to register the finders with the NASD as associated persons.¹⁴²

The decision may be more of a testament to the NASD's failure to put on sufficient proof than an indication of leniency on the part of the Commission toward finders. The Commission's decision expressly referred to the lack of evidence demonstrating that the finders repeatedly referred prospective purchasers, made any sales pitch or recommendation, or had any contact at all with prospective purchasers.¹⁴³ Indeed, the bare factual record allowed for the possibility that the finders merely may have on one occasion submitted a list of names to the member firm. Thus, even though the finders received fees equal to five percent of the initial investments made by persons that they

tions were imposed only on the broker-dealer, and the Commission did not discuss whether the person's activities would require broker-dealer registration, most likely because this person's association with the broker-dealer would subject him to the firm's supervision and control. Under section 15(b)(4)(E)(i)-(ii) of the Exchange Act, broker-dealers are subject to sanctions by the Commission for failing reasonably to supervise their associated persons who commit violations of the statutory or regulatory provisions of the federal securities laws, unless there were established procedures, and a system for applying them, that "would reasonably be expected to prevent and detect [the violations], insofar as practicable," and the broker-dealers have "reasonably discharged [their] duties and obligations . . . [under] such procedures and system without reasonable cause to believe that such procedures and system were not being complied with." 15 U.S.C. § 78o(b)(4)(E)(i)-(ii) (1988).

141. *Traiger Energy Invs.*, Exchange Act Release No. 25,306, 40 SEC Docket 185 (Feb. 3, 1988).

142. *Id.* at 186-87.

143. *Id.*

referred, the Commission held that the finders were not engaged in the securities business on behalf of the firm.¹⁴⁴

By not requiring these finders to be associated persons of a registered broker-dealer, the Commission may have intended to imply that their activities did not require broker-dealer registration. If so, the decision does not reflect sound policy. Persons receiving compensation based on the outcome of a transaction have a powerful incentive to do whatever is necessary to make that transaction succeed. The compensation received by the finders in *Traiger* provided that incentive, and it could have been a sufficient basis upon which to affirm the NASD's sanctions. By contrast, there was simply no evidence that those finders actually did engage in conduct beyond the scope of their limited activities, which is the danger in any finder's arrangement. It thus may be implied that the Commission apparently would not agree that receipt of transaction-based compensation alone would cause a person to be deemed a broker-dealer.¹⁴⁵ It also may be possible, however, to regard the *Traiger* decision as being limited to its facts, or rather, lack of facts.¹⁴⁶

F. Analysis

In essence, the finders described above have argued to the staff, and sometimes to the Commission, that they have not effected securities transactions, but merely referred interested persons to registered broker-dealers who effected any resulting transactions. In most cases, that argument has proven to be too narrow. The Commission historically has held that effecting transactions includes more than merely performing the physical actions necessary to complete those transactions. For example, when an intrastate broker-dealer mailed circulars, securities, and confirmations beyond state borders, the Commission held that broker-dealer registration was required, rejecting the argument that the registration requirements of section 15(a) of the Ex-

144. *Id.* at 187. The NASD requires that persons associated with a member firm "who are engaged in the investment banking or securities business for the member" must be "registered as such with the [NASD]." NASD Schedules to By-Laws, Schedule C, Part III, § 1(a), reprinted in NASD Manual (CCH) ¶ 1753, at 1542 (Apr. 1991).

145. See McGivney Securities, SEC No-Action Letter, *supra* note 78 and accompanying text.

146. Certainly, the strong condemnation of very similar arguments made by the associated person in Allen S. Klosowski, *supra* note 133 and accompanying text, supports this reading.

change Act¹⁴⁷ applied "only to the *actual consummation* of the purchase or sale of securities" outside state borders.¹⁴⁸

In the context of interpreting section 11(a) of the Exchange Act,¹⁴⁹ the Commission also has indicated that the term "effect" should be broadly construed. In a 1976 release, the Commission stated that an exchange member would "effect" a transaction, for the purposes of section 11(a), "even though the services of another [exchange] member [were] utilized to execute the transaction."¹⁵⁰ In a subsequent release, the Commission rejected arguments that it was interpreting "effect" too broadly, because the word was not qualified in section 11(a) by the phrase "directly or indirectly."¹⁵¹ The Commission explained that, while "effect" is modified by the phrase "directly or indirectly" in several places in the Exchange Act,¹⁵² "the word 'effect,' and its cognates, are more often used alone, in contexts (other than Section 11(a)) where a *constricted interpretation would be wholly inappropriate*," specifically citing section 3(a)(4) and section 15(a), among other provisions.¹⁵³

Arguments that referral activities were not the finders' principal business also have been rejected. In effect, there is no "de minimus" exception from broker-dealer registration.¹⁵⁴ This position is sound, as it avoids the trouble-

147. 15 U.S.C. § 78o(a)(1) (1988). Section 15(a)(1) states, in pertinent part, that:

It shall be unlawful for any broker or dealer . . . (other than such a broker or dealer whose business is exclusively intrastate and who does not make use of any facility of a national securities exchange) to make use of the mails or any means or instrumentality of interstate commerce *to effect any transactions in*, or to induce or attempt to induce the purchase or sale of, any security . . . unless such broker or dealer is registered [with the Commission].

Id. (emphasis added).

148. Securities Exch. Corp., 2 S.E.C. 760, 762 (1937) (emphasis added).

149. 15 U.S.C. § 78k(a) (1988).

150. Exchange Act Release No. 12,055, [1975-1976 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,367, at 85,974 (Jan. 27, 1976).

151. Exchange Act Release No. 13,388, [1976-1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,013, at 87,698 (Mar. 18, 1977).

152. *See, e.g.*, Exchange Act, §§ 5, 9(a), 30, 15 U.S.C. §§ 78e, 78i(a), 78dd (1988).

153. Exchange Act Release No. 13,388, *supra* note 151, at 87,698 (emphasis added). The Commission also noted that "the Congress added qualifying phrases in other sections where a narrower meaning was intended," including sections 3(a)(3), 6(c)(4), 6(f)(1), and 6(f)(2) of the Exchange Act, 15 U.S.C. §§ 78c(a)(3), 78f(c)(4), 78f(f)(1), 78f(f)(2) (1988). *Id.*

154. WEISS, *supra* note 4, at 7-8 (footnote omitted). Weiss stated that:

[T]here is nothing in the definitions of broker and dealer which would warrant a conclusion that a person cannot be engaged in the business in respect of securities merely because such business is only a minor part of the person's activities or merely because the income from it represents only a small fraction of his total income. On the contrary, if the activity is engaged in for commissions or other compensation with sufficient recurrence to justify the inference that the activity is part of the per-

some administrative problem of trying to set a fixed, acceptable level of broker-dealer activity by unregistered persons.

There is one judicial decision in the broker-dealer area that, by analogy, appears to provide some guidance.¹⁵⁵ A discount brokerage firm,¹⁵⁶ which was a NASD member, appealed the Commission's order upholding the NASD's decision requiring the firm to register persons who only took orders from customers¹⁵⁷ as general securities representatives. The broker-dealer argued that the order-takers performed only clerical and ministerial functions. The NASD, however, reasoned that order-taking was more than a clerical or ministerial act, and that the regular and continuous contact of these persons with the public warranted registration. The Commission found that the order-takers had to be familiar with the securities business and able to answer questions competently. Therefore, the Commission deferred to the NASD's long-standing policy of requiring anyone taking orders from the public to register.¹⁵⁸

The appellate court, in upholding the Commission's order, found that the regular and continuous contact of the order-takers with the public was a reasonable rationale for the NASD's policy.¹⁵⁹ The court deferred to the Commission's expertise on what would be in the public interest, noting that these "personnel may stray from their limited duties during public contact resulting in harm to investors."¹⁶⁰ This case was decided on the question of what constituted clerical and ministerial activity, rather than whether the order-takers were engaged in the business of effecting securities transactions. Nevertheless, the issues raised by regular and continuous public contact, and the harm that could result if so-called "limited" duties were disregarded,

son's business, he will be deemed to be "engaged in the business" within the meaning of that term as used in the definitions of broker and dealer.

Id.; see also JAFFE, *supra* note 52, § 2.04, at 20 n.32 ("[T]he registration requirements apply whether or not a person is an amateur or professional and whether or not employment in the securities business is on a full or part-time basis.") (citing *Boruski v. SEC*, 289 F.2d 738, 740 (2d Cir. 1961) (dictum)).

155. *Exchange Servs. Inc. v. SEC.*, 797 F.2d 188 (4th Cir. 1986).

156. A "discount broker" typically executes trades at commission rates sharply lower than those charged by a "full service broker." The discount broker does not provide any of the other services generally offered by a full service broker, such as making recommendations to buy or sell particular securities, asset management, advice on financial planning and tax shelters, and the opportunity to purchase new issues of securities. JOHN DOWNES & JORDAN ELLIOT GOODMAN, *BARRON'S DICTIONARY OF FINANCE AND INVESTMENT TERMS* 99, 150 (2d ed. 1985) (Barron's).

157. *Exchange Servs., Inc. v. SEC.*, 797 F.2d at 188.

158. *Id.* at 189.

159. *Id.* at 190-91.

160. *Id.* at 190.

invites a favorable comparison with finders referring investors to broker-dealers, and suggests equally strict scrutiny and, if necessary, regulation.¹⁶¹

IV. REFERRING INVESTORS TO ISSUERS

A second major class of finders engages in activities designed to assist issuers seeking financing by referring potential investors directly to those issuers.¹⁶² These finders include persons who promote the sale of a new issue of securities,¹⁶³ financial advisers who provide consulting services regarding the issuance of securities, persons who facilitate merger and acquisition activities, so-called "business brokers," and persons who match investors with entrepreneurs seeking financing.¹⁶⁴ Many of these finders have received no-action positions from the staff. The staff's negative responses, however, are more instructive, as they more clearly reflect the boundaries of the permissible activities of these finders.

161. In fact, the NASD sought comments on a proposed amendment to Schedule C of its by-laws restricting the payment of finder's fees or referral fees by NASD members to unregistered third parties for referral of retail business. Fees paid in connection with underwriting or merger and acquisition activities would be permitted, however, and occasional fixed-amount referral fees also would be allowed. See NASD Notice to Members No. 89-3 (Jan. 1989). To date, the NASD has not formally filed this amendment with the Commission as a proposed rule change.

162. See Don Augustine & Peter Fass, *Finder's Fees in Security and Real Estate Transactions*, 35 BUS. LAW. 485 (1980).

163. Item 508(i) of Regulation S-K requires issuers, in registration statements filed with the Commission, to "[i]dentify any finder and, if applicable, describe the nature of any material relationship between such finder and the registrant, its officers, directors, principal stockholders, finders or promoters or the principal underwriter(s), or if there is a managing underwriter(s), the managing underwriter(s) (including, in each case, affiliates or associates thereof)." 17 C.F.R. § 229.508(i) (1991).

164. One distinct group of persons referring investors to issuers will not be discussed in this paper: directors, officers, or employees of issuers who sell only that issuer's securities to the public. The Commission has adopted Rule 3a4-1, 17 C.F.R. § 240.3a4-1 (1991), to exempt these persons from the definition of broker upon certain conditions. To claim the exemption, these persons must not: (i) be subject to a statutory disqualification; (ii) receive transaction-based compensation; or (iii) be associated persons of a registered broker-dealer. 17 C.F.R. § 240.3a4-1(a)(1)-(3) (1991). These persons may sell the issuer's securities in three different ways. First, they may sell to specified institutions (the "financial institutions" prong of the rule). Second, they may sell to the public in general, if they perform substantial other duties for the issuer, were not associated with a broker-dealer during the preceding 12 months, and do not participate in an offering of the issuer's securities more than once every 12 months, except in reliance on the other prongs in the rule (the "active sales" prong). Third, they may sell by merely preparing written communications, responding to investors' inquiries, and performing clerical and ministerial activities (the "passive sales" prong). 17 C.F.R. § 240.3a4-1(a)(4) (1991).

A. Sale of New Issues of Securities

The staff has taken several no-action positions regarding the activities of persons who proposed to refer investors to issuers in connection with the sale of new issues of securities,¹⁶⁵ including associations of investors.¹⁶⁶ For the most part, these persons or organizations genuinely appear to have done nothing more than bring interested parties together or refer potential investors to issuers, without participating in any negotiations between the two. On at least one occasion, however, such a finder obtained a staff no-action position, despite receipt of a fee based on a percentage of the amount invested by the referred persons.¹⁶⁷

More recently, the staff responded to an interesting request from a finder who proposed to locate investors for a new Canadian hockey team trying to raise money through an offering of limited partnership units in the United States and Canada.¹⁶⁸ The finder wanted to contact potential investors among his business and personal associates in return for a commission on sales to any persons whom he had contacted. The staff's response, however, indicates that the finder was limited to sending the hockey team a list of potential investors rather than contacting them himself.¹⁶⁹ Thus, the finder's receipt of transaction-based compensation may not have been deemed an incentive to engage in abusive sales practices, because the finder would have no contact at all with prospective investors. Moreover, the finder represented that he had never acted as a finder before and would not do so again.

Conversely, the staff has denied no-action positions based on both the finders' proposed activities and their compensation.¹⁷⁰ If the finder pro-

165. See, e.g., Charles H. Swanke, SEC No-Action Letter, 1980 SEC No-Act. LEXIS 3376 (May 6, 1980); Moana/Kauai Corp., SEC No-Action Letter, 1974 SEC No-Act. LEXIS 63 (July 10, 1974).

166. See, e.g., Northeastern Pa. Synod of the Evangelical Lutheran Church in Am., SEC No-Action Letter, [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,697 (Mar. 31, 1988) (investment committee for congregations within synod); Delaware Inv. Found., SEC No-Action Letter, 1986 SEC No-Act. LEXIS 3069 (Nov. 6, 1986) (association of local construction industry pension trusts); Florida Affirmative Inv. Roundtable, SEC No-Action Letter, 1983 SEC No-Act. LEXIS 2722 (July 21, 1983) (same); Tri-State Inv. Found., SEC No-Action Letter, 1982 SEC No-Act. LEXIS 2844 (Aug. 5, 1982) (same); Construction Indus. Real Estate Dev. Fin. Found. of S. Cal., SEC No-Action Letter, 1980 SEC No-Act. LEXIS 4016 (Oct. 2, 1980) (same).

167. Moana/Kauai Corp., SEC No-Action Letter, *supra* note 165.

168. Paul Anka, SEC No-Action Letter, 1991 SEC No-Act. LEXIS 925 (July 26, 1991).

169. Cf. Traiger Energy Invs., Exchange Act Release, *supra* notes 141-44 and accompanying text (finders merely may have submitted a list of names of potential investors to the NASD member firm).

170. See, e.g., Richard S. Appel, SEC No-Action Letter, 1983 No-Act. LEXIS 2035 (Jan. 13, 1983); John DiMeno, SEC No-Action Letter, 1978 No-Act. LEXIS 2188 (Oct. 11, 1978);

posed to advertise bid and asked quotations in the issuer's securities¹⁷¹ or received compensation based on a percentage of funds loaned or invested,¹⁷² the staff apparently felt that the boundaries of broker-dealer activity had been crossed.¹⁷³ On occasion, the Commission has authorized the bringing of enforcement actions against "investor finders" who received fees for locating potential purchasers of an issuer's securities.¹⁷⁴

B. Financial Advisers

The staff also has taken no-action positions regarding the activities of persons proposing to act as financial advisers to businesses in connection with the issuance of securities.¹⁷⁵ These persons generally would provide market and financial analyses, prepare feasibility studies, hold meetings with registered broker-dealers, prepare or supervise the preparation of registration statements and offering memoranda, and otherwise assist the issuer in structuring the offering. The staff, however, has required broker-dealer registration of these persons if they received compensation based on the outcome of

Sidney Marks, SEC No-Action Letter, 1977 No-Act. LEXIS 2057 (July 7, 1977); General Stock Transfer Co., SEC No-Action Letter, [1971-1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,402 (Aug. 4, 1971).

171. General Stock Transfer Co., SEC No-Action Letter, *supra* note 170.

172. Sidney Marks, SEC No-Action Letter, *supra* note 170; John DiMeno, SEC No-Action Letter, *supra* note 170; Richard S. Appel, SEC No-Action Letter, *supra* note 170.

173. In one interesting case, a finder who claimed that he would avoid participating in negotiations, but would receive a five percent commission, pressed the staff for reconsideration of the denial of his no-action request. John DiMeno, SEC No-Action Letter, *supra* note 170. Counsel apparently persuaded the staff to relent by arguing that the finder had not engaged, and would not in the future engage, in any other efforts to locate investors for issuers. John DiMeno, SEC No-Action Letter, 1979 No-Act. LEXIS 2791 (Mar. 2, 1979); *cf.* Paul Anka, SEC No-Action Letter, *supra* notes 168-69 and accompanying text.

174. *See, e.g.*, SEC v. Miller Fin. Corp., Litigation Release No. 10,537, 31 SEC Docket 514 (Sept. 20, 1984) (finders consented to permanent injunction against violation of section 15(a)); SEC v. Solomon, Litigation Release No. 10,078, 28 SEC Docket 552 (July 26, 1983) (no reported decision); SEC v. Reliance Capital Corp., Litigation Release No. 5365, 1972 SEC LEXIS 1633 (Mar. 30, 1972) (no reported decision).

175. *See, e.g.*, Vincent Forma, SEC No-Action Letter, 1985 SEC No-Act. LEXIS 3075 (Oct. 11, 1985); Dominion Resources, Inc., SEC No-Action Letter, 1985 SEC No-Act. LEXIS 2511 (July 23, 1985); Columbia Transfer Co., SEC No-Action Letter, 1976 SEC No-Act. LEXIS 1245 (May 28, 1976) (inviting broker-dealers to join together to act as co-underwriters in proposed offerings); Albert Pitts, SEC No-Action Letter, 1975 SEC No-Act. LEXIS 440 (Jan. 27, 1975).

the offering or the amount of financing raised,¹⁷⁶ or if they participated in negotiations between the issuer and investors.¹⁷⁷

C. Mergers and Acquisitions

Arranging mergers and acquisitions is an area in which finders seem particularly active. These finders may be deemed to effect securities transactions if the mergers or acquisitions are accomplished through the issuance, transfer, or exchange of securities.¹⁷⁸ Surprisingly, however, there are very few staff no-action letters on this topic.

Many of the staff's letters consist only of general statements of law and expressly refrain from taking no-action positions.¹⁷⁹ The staff has emphasized that if there were a distribution or an exchange of securities in connection with the merger or acquisition, broker-dealer registration would be required.¹⁸⁰ In addition, persons receiving a commission for their efforts, based on the cost of the securities exchanged or on the amount of securities

176. Thomas J. DiBiase, SEC No-Action Letter, 1988 SEC No-Act. LEXIS 440 (Jan. 18, 1988); Capital Directions, Inc., SEC No-Action Letter, 1979 SEC No-Act. LEXIS 2051 (Jan. 4, 1979); Gunnar/Burkhart/Armstrong & Assocs., SEC No-Action Letter, 1975 SEC No-Act. LEXIS 2617 (Oct. 28, 1975).

177. See, e.g., Capital Directions, Inc., SEC No-Action Letter, *supra* note 176; R.T. Madden & Co., SEC No-Action Letter, 1976 SEC No-Act. LEXIS 2240 (Sept. 17, 1976); Gunnar/Burkhart/Armstrong & Assocs., SEC No-Action Letter, *supra* note 176.

178. In *SEC v. Century Inv. Transfer Corp.*, No. 71 Civ. 3384, [1971-1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,232 (S.D.N.Y. Oct. 5, 1971), the defendant company acted as a broker for purchasers and sellers of shell corporations. The company solicited customers through newspaper advertisements. It sought to effect mergers between privately-held corporations and publicly-held shell corporations controlled by an affiliate. Although there was no mention of the defendant's compensation for these activities, a preliminary injunction against violations of the broker-dealer registration requirements was granted. *Id.*

In an unrelated private action, a plaintiff sued to void his agreement with defendant, a merger and acquisitions specialist, because the merger took too long to arrange and defendant refused to reduce his fee. In its unpublished decision, *Snyder v. McGuire*, Civil Action No. CA-3-82-1453-D (N.D. Tex. June 30, 1983), the court granted summary judgment for plaintiff. The court reasoned that: the contract involved a securities transaction; defendant was a broker because he was in the business of buying and selling securities for the account of others; defendant attempted to induce the purchase of securities by others to raise funds for plaintiff's acquisition; and defendant was not registered with the Commission. The court relied on section 29(b) of the Exchange Act, 15 U.S.C. § 78cc(b) (1988), the rationale in *Regional Properties, Inc. v. Financial & Real Estate Consulting Co.*, 678 F.2d 552 (5th Cir. 1982), and some of the staff no-action letters in this area.

179. See, e.g., Prescott-Gross & Assocs., SEC Interpretative Letter, 1980 SEC No-Act. LEXIS 2637 (Jan. 11, 1980); IMF Corp., SEC Interpretative Letter, 1978 SEC No-Act. LEXIS 1246 (May 15, 1978); The Executive Suite, SEC Interpretative Letter, 1975 SEC No-Act. LEXIS 1740 (Aug. 20, 1975); Philip Roman, SEC Interpretative Letter (June 28, 1974); Ruth Quigley, SEC Interpretative Letter, 1973 SEC No-Act. LEXIS 3177 (July 14, 1973).

180. See *supra* note 179.

placed, also would be deemed brokers or dealers.¹⁸¹ On the other hand, individuals who only bring together merger or acquisition-minded persons and who do not participate, directly or indirectly, in the distribution of securities, or share in the profits realized, likely would not be deemed brokers or dealers and would not be required to register. The staff also has found it important that the finder not participate in any negotiations between the parties subsequent to the finder bringing them together.¹⁸²

The staff has denied a few no-action requests regarding merger and acquisition finders.¹⁸³ Perhaps the most representative letter involved a private investment banking firm acting principally as an intermediary for companies seeking venture capital and permanent financing.¹⁸⁴ The firm acted as a consultant regarding mergers and asset sales, reviewed financial reports, and advised management on financial decisions. The firm received commissions based on the price at which a transaction was consummated and occasionally participated in negotiations concerning the transaction. Emphasizing the firm's participation in negotiations, the staff determined that broker-dealer registration would be required.¹⁸⁵

In a later letter, May-Pac Management Company, a consulting firm specializing in mergers and acquisitions, proposed to bring together potential buyers and sellers of corporations in order to complete a transaction.¹⁸⁶ The firm would participate in negotiations between the parties and receive compensation based on a percentage of the transaction price obtained for the selling or merging client. Not surprisingly, the staff responded that persons who play an integral role in negotiating and effecting mergers or acquisitions that involve transactions in securities would be required to register as broker-dealers.¹⁸⁷ Therefore, if the consulting firm's proposed activities included securities transactions, registration would be required.¹⁸⁸ The denial of this no-action request on this topic provoked negative comments from the securities bar.

181. *Id.*

182. *Id.* The staff has taken care to exclude from the reach of this prohibition, however, professional advisers, such as lawyers or accountants, acting in their respective capacities. The Executive Suite, SEC Interpretative Letter, *supra* note 179.

183. See WOLFSON ET AL., *supra* note 62, § 1.10.

184. Fulham & Co., Inc., SEC No-Action Letter, 1972 SEC No-Act. LEXIS 4488 (Nov. 21, 1972).

185. *Id.*

186. May-Pac Management Co., SEC No-Action Letter, 1973 SEC No-Act. LEXIS 1117 (Nov. 20, 1973).

187. *Id.*

188. *Id.*

A subcommittee of the Chicago Bar Association wrote to the staff, urging that registration not be required in certain circumstances.¹⁸⁹ These included occasions when a finder's merger and acquisition activities were limited to bringing persons together and participating in their negotiations, only to the extent of negotiating the finder's compensation and keeping the parties negotiating to complete the transaction. Counsel argued that these finders should be deemed to effect transactions, and be required to register, only when they had the authority to consummate the transactions and bind their principals within the scope of the principals' instructions. The staff responded that the May-Pac Management Company letter was consistent with previous staff positions and contemporaneous case law.¹⁹⁰ The staff also maintained that the factors mentioned by counsel would not be determinative in all cases.¹⁹¹ This response seems correct. While counsel may have construed properly the meaning of effecting transactions under the law of agency, the scope of effecting transactions within the context of the federal securities laws is much broader.¹⁹²

D. Business Brokers

A related group of finders engages in the business of bringing together buyers and sellers of businesses.¹⁹³ In this area, the staff also has issued more general statements than no-action letters, most likely due to the fact-intensive nature of the question of whether these finders are acting as brokers.¹⁹⁴ The staff has stressed that these finders should avoid holding clients' securities, giving investment advice, or counseling prospective buyers or sell-

189. Paul B. Uhlenhop, Esq., SEC Interpretative Letter (Apr. 1, 1975).

190. See *SEC v. Century Inv. Transfer Corp.*, No. 71 Civ. 3384, [1971-1972 Transfer Binder] Fed. Sec. L. Rep. § 93,232 (S.D.N.Y. Oct. 5, 1971).

191. *Id.*

192. See *supra* notes 112-13 and accompanying text.

193. See Michael Bamberger, *Sales of Businesses — When Are Business Brokers Securities Brokers?*, 71 MARQ. L. REV. 309 (1988). In *Landreth Timber Co. v. Landreth*, 471 U.S. 681 (1985), the Supreme Court held that the sale of a business by means of transferring ownership of all of a company's stock constituted a securities transaction entitled to the protection of the federal securities laws. The federal circuit courts had been divided over this question, which was known as the "sale of business" doctrine. See, e.g., Stephen J. Easley, *Recent Developments in the Sale of Business Doctrine: Toward a Transactional Context-Based Analysis for Federal Securities Jurisdiction*, 39 BUS. LAW. 929 (1984).

194. See, e.g., *Wesco Equity Funding*, SEC Interpretative Letter, 1985 SEC No-Act. LEXIS 2634 (Aug. 10, 1985); *Garrett/Kushell/Associates*, SEC Interpretative Letter, 1980 SEC No-Act. LEXIS 3744 (Sept. 7, 1980); *Castagan Business Brokerage, Inc.*, SEC Interpretative Letter, 1980 SEC No-Act. LEXIS 3298 (May 15, 1980); *Gary L. Pleger, Esq.*, SEC Interpretative Letter, 1977 SEC No-Act. LEXIS 2491 (Oct. 11, 1977); *Bay Business Serv.*, SEC Interpretative Letter, 1977 SEC No-Act. LEXIS 642 (Mar. 14, 1977); *Dennis L. Whitman, Esq.*, SEC Interpretative Letter (Jan. 23, 1974).

ers.¹⁹⁵ The same factors applied to merger and acquisition finders have been deemed relevant in this context. The factors include the permissibility of bringing together persons interested in buying or selling businesses and the impermissibility of playing an integral role in negotiating and effecting purchases or sales of businesses involving securities transactions.¹⁹⁶ Particular emphasis also has been placed on receipt of compensation based on the cost or value of securities involved in the purchase or sale.¹⁹⁷

Apparently, the staff has issued only two no-action positions on this topic.¹⁹⁸ The absence of any additional letters since these were issued may indicate that the staff would prefer counsel to be guided by the statements in those letters rather than request individual no-action positions. Indeed, the no-action letter to International Business Exchange Corporation sets out a definitive list of the factors that the staff believes should be considered in determining whether a business broker should register as a broker-dealer with the Commission. These factors include whether:

- (i) the business broker plays only a limited role in negotiations between the parties;
- (ii) the businesses bought and sold are going concerns and not shells;
- (iii) only assets are advertised or offered for sale;
- (iv) any transactions in securities involve the transfer of all the equity in the business to a single purchaser or group formed without the business broker's assistance;
- (v) the business broker gives no advice whether to issue securities or regarding their value;
- (vi) the business broker's compensation does not vary with the form of conveyance; and
- (vii) the business broker provides no assistance in obtaining financing, except for providing lists of potential lenders.¹⁹⁹

On the whole, these factors define the staff's view on the limits of business brokers' permissible activities in light of the broker-dealer registration re-

195. See *supra* note 193.

196. See *supra* note 194. As with merger and acquisition finders, see *supra* note 136 and accompanying text, the staff has excluded from this analysis professional advisers, such as lawyers and accountants, acting in their professional capacities, even though they undeniably can play an integral role in consummating the purchase or sale of a business. Garrett/Kushell/Associates, SEC Interpretative Letter, *supra* note 194.

197. See, e.g., Gary L. Pleger, SEC Interpretative Letter, *supra* note 194; Castagan Business Brokerage, Inc., SEC Interpretative Letter, *supra* note 194; Garrett/Kushell/Associates, SEC Interpretative Letter, *supra* note 194.

198. Victoria Bancroft, SEC No-Action Letter, 1987 SEC No-Act. LEXIS 2517 (July 9, 1987); International Business Exch. Corp., SEC No-Action Letter, 1986 SEC No-Act. LEXIS 3065 (Dec. 12, 1986).

199. International Business Exch. Corp., SEC No-Action Letter, *supra* note 198.

quirements. They also reveal some of the essential attributes of the definition of broker. These include negotiating the terms of securities transactions, giving advice on the value of securities, receiving compensation based on the outcome of securities transactions, and providing assistance in financing securities transactions.

E. Matching Services

Increased interest in encouraging entrepreneurship and providing sources of venture capital has given birth to a new type of finder, who refers investors to issuers through matching services. Potentially, these services are subject to the broker-dealer registration requirements if they facilitate financing of entrepreneurs by investors through the issuance or transfer of securities. The staff has not required registration of these matching services, however, to the extent that they serve merely as clearinghouses for information.²⁰⁰ The first staff no-action letter released in this area has served as the model for the many that have followed.²⁰¹

In *Venture Capital Network, Inc.*, a company proposed to operate a computer matching service to link investors with entrepreneurs seeking financing.²⁰² The entrepreneurs and investors would deal directly with each other after review by the investors of the entrepreneurs' business plans.²⁰³ The

200. See *infra* notes 201-09.

201. Venture Capital Network, Inc. (VCN), SEC No-Action Letter (Feb. 8, 1984). VCN also received a no-action position on investment adviser registration. Venture Capital Network, Inc., SEC No-Action Letter, [1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,660, at 78,987 (Apr. 5, 1984). The staff of the Division of Investment Management stated that VCN would be providing "analyses or reports concerning securities" within the meaning of "investment adviser" under section 202(a)(11) of the Investment Advisers Act of 1940 (Advisers Act), 15 U.S.C. § 80b-2(a)(11) (1988), but not "as part of a regular business" within the meaning of that section. *Id.* at 78,991-92. VCN was a nonprofit organization, and no compensation would be paid to any director, officer, employee, or other person for providing reports concerning securities. *Id.* at 78,992. Moreover, the small business development program within the state university system, which would process, for a fee, information from questionnaires submitted by users of the service, was deemed to be a state instrumentality itself, exempt from registration as an investment adviser under section 202(b) of the Advisers Act. *Id.* Subsequent requests resulted in no-action positions on investment adviser registration. See, e.g., University of Ark., SEC No-Action Letter, 1986 SEC No-Act. LEXIS 3061 (Oct. 6, 1986); Investment Contact Network, SEC No-Action Letter, 1986 SEC No-Act. LEXIS 3066 (Sept. 8, 1986); Venture Capital Exch., Inc., SEC No-Action Letter, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,310, at 76,937 (Mar. 24, 1986); Indiana Inst. for New Business Ventures, Inc., SEC No-Action Letter, [1985-1986 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,189, at 76,768 (Dec. 11, 1985). The more recent requests have not addressed this issue, perhaps because the Division of Investment Management no longer regards the question as an open one.

202. Venture Capital Network, Inc., SEC No-Action Letter (Feb. 8, 1984).

203. *Id.*

staff's no-action position was based on the premise that the matching system's operator would avoid certain activities, including:

- (i) advising entrepreneurs or investors on the merits of particular opportunities;
- (ii) receiving fees from users of the matching service, other than one-time, nominal application fees to cover administrative costs;
- (iii) participating in the negotiation of the terms of the investors' investments in the entrepreneurs' businesses;
- (iv) holding itself out as providing anything more than an introductory computer match;
- (v) providing information concerning how an investor and an entrepreneur could complete a transaction after the introductory match; and
- (vi) handling funds or securities involved in completing a transaction.²⁰⁴

The staff has approved similar matching services sponsored by state instrumentalities,²⁰⁵ private, nonprofit corporations,²⁰⁶ and quasi-governmental organizations.²⁰⁷ The latter class of sponsors has posed problems for the staff, perhaps because the staff believes that conflicts of interest could arise if the owners were also users of such systems. As a result, the staff has required representations that such systems would be run solely on a cost recovery basis, and not for the profit of their owners.²⁰⁸ In addition, the staff has required that the founders, incorporators, directors, officers, and employees of the quasi-governmental organization and the corporations over

204. *Id.*

205. *See, e.g.*, Kansas Venture Capital Network, SEC No-Action Letter, 1988 SEC No-Act. LEXIS 1061 (Aug. 8, 1988); Private Investor Network, SEC No-Action Letter, 1987 SEC No-Act. LEXIS 52 (Oct. 2, 1987); Mississippi Research & Dev. Ctr. & Miss. Venture Capital Clearing House, SEC No-Action Letter, 1987 SEC No-Act. LEXIS 2510 (June 18, 1987); Venture Capital Network of N.Y., Inc., SEC No-Action Letter, 1986 SEC No-Act. LEXIS 3062 (Oct. 15, 1986); University of Ark., SEC No-Action Letter, *supra* note 201; Investment Contact Network, SEC No-Action Letter, *supra* note 201; Indiana Inst. for New Business Ventures, SEC No-Action Letter, *supra* note 201.

206. *See, e.g.*, Heartland Venture Capital Network, Inc., SEC No-Action Letter, 1987 SEC No-Act. LEXIS 2213 (May 7, 1987); Wyoming Small Business Dev. Ctr., SEC No-Action Letter, 1987 SEC No-Act. LEXIS 2319 (Apr. 13, 1987); Venture Capital Exch., Inc., SEC No-Action Letter, *supra* note 201.

207. *See, e.g.*, Venture Match of N.J., SEC No-Action Letter, 1988 SEC No-Act. LEXIS 2225 (May 11, 1988); Venture Capital Network of N.Y., Inc., SEC No-Action Letter, 1988 SEC No-Act. LEXIS 388 (Jan. 13, 1988); VCN of Tex., SEC No-Action Letter, 1987 SEC No-Act. LEXIS 2225 (May 18, 1987); Venture Capital Network of N.Y., Inc., SEC No-Action Letter, 1987 SEC No-Act. LEXIS 2077 (Mar. 6, 1987); Atlanta Economic Dev. Corp., SEC No-Action Letter, 1987 SEC No-Act. LEXIS 1846 (Feb. 17, 1987).

208. *See, e.g.*, Atlanta Economic Dev. Corp., SEC No-Action Letter, *supra* note 207.

which these persons exercise control would not participate in the matching service as entrepreneurs or investors.²⁰⁹

The staff's positions in this area are appropriate. Any benefits to be gained by requiring these matching services to register as broker-dealers are outweighed by the increasing role that the services play in generating investment capital for small businesses. The services are providing information and not acting as an instrumentality through which securities are purchased or sold. The financial responsibility concerns militating in favor of broker-dealer registration are not present, because these services are not holding the funds or securities of their users. Finally, the conflict-of-interest condition seems appropriate if the owners or affiliates of matching services are able to use the services. This condition does not apply if the services are owned by state instrumentalities or private, nonprofit corporations not investing or engaging in entrepreneurial activity.

V. REFERRING INVESTORS TO OTHER INVESTORS

The final class of finders that this article will discuss is composed of persons who attempt to arrange trades between buyers and sellers of securities. Because this intermediary function is perhaps at the core of broker-dealer activity, the staff may have been unwilling to take no-action positions in this area, as it has in some of the other areas discussed above. For example, a person who inquired whether he could charge a pre-arranged fee for arranging securities transactions between private investors was denied a definitive response.²¹⁰ Another person stated that he wished to arrange for individuals to exchange tax-exempt bonds by placing advertisements in newspapers describing the bonds in detail.²¹¹ He would then put the owners in touch with each other and receive a fee based on the value of the bonds exchanged. The staff stated that, under such circumstances, broker-dealer registration would be required.²¹² Other persons who proposed to prepare and distribute

209. *Id.*

210. Joseph McGulley, SEC Interpretative Letter (Feb. 18, 1975).

211. A.E. Grudin, SEC Interpretative Letter, 1981 SEC No-Act. LEXIS 4341 (Nov. 30, 1981).

212. *Id.* Counsel asked the staff to reconsider, arguing that, beyond introducing the parties to each other, his client did not negotiate or take an active role in completing these transactions. Counsel also argued that his client was merely supplying names of interested persons to others. The staff remained adamant, however, stressing that counsel's client was engaged in continuous, public solicitation of investors to facilitate trades or swaps, matching securities to determine the comparability of various issues, and receiving compensation for completed transactions. The staff added that it could not assure counsel that no enforcement action would be recommended if the client proceeded as described. A.E. Grudin, SEC No-Action Letter (Dec. 23, 1981).

lists of their securities holdings were informed that this activity could constitute both a regular business, within the definition of dealer in section 3(a)(5),²¹³ and an attempt to induce securities transactions, within the meaning of section 15(a)(1).²¹⁴ In addition, an employee of a government securities broker, who proposed to engage in transactions in corporate bonds by inviting sellers of those bonds to make offers at prices that would include a commission payable upon finding buyers and executing the sales, was told flatly that broker-dealer registration was required and received a registration application by return mail.²¹⁵

A. Listing Services

The staff has been more lenient if persons seeking to match investors with each other are willing to limit their activities to providing information only, by essentially serving as a bulletin board. These individuals are also willing to eschew receipt of any compensation based on the occurrence or value of resulting securities transactions. This type of listing service sponsored by third parties²¹⁶ or by issuers themselves²¹⁷ has received no-action treatment from the staff regarding broker-dealer registration.²¹⁸ Generally, listing services provide only information about securities available for purchase or

213. 15 U.S.C. § 78c(a)(5) (1988).

214. 15 U.S.C. § 78o(a)(1) (1988); *see* Robert C. DeFazio, SEC Interpretative Letter, 1981 SEC No-Act. LEXIS 4408 (Dec. 17, 1981).

215. Ethan M. Heisler, SEC Interpretative Letter, 1983 SEC No-Act. LEXIS 2887 (Sept. 25, 1983).

216. *See, e.g.*, Investex Inv. Exch., Inc., SEC No-Action Letter, 1990 SEC No-Act. LEXIS 609 (Apr. 9, 1990); Petroleum Info. Corp., SEC No-Action Letter, 1989 SEC No-Act. LEXIS 1236 (Nov. 28, 1989) (taking no position on the application of proposed Rule 15c2-10, which would provide for the Commission's review of proprietary trading systems not operated as facilities of national securities exchanges); *see also* Proprietary Trading Sys., Exchange Act Release No. 26,708 (Apr. 11, 1989), 54 Fed. Reg. 15429 (Apr. 18, 1989); Troy Capital Servs., Inc., SEC No-Action Letter, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,975, at 78,903 (Apr. 28, 1989); Real Estate Fin. Partnership, SEC No-Action Letter, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,994, at 78,903 (Apr. 4, 1989).

217. Farmland Indus., Inc., SEC No-Action Letter, 1991 SEC No-Act. LEXIS 1187 (Aug. 26, 1991); Tri-State Livestock Credit Corp., SEC No-Action Letter, 1989 SEC No-Act. LEXIS 1058 (Oct. 18, 1989); CNB Corp., SEC No-Action Letter, 1989 SEC No-Act. LEXIS 758 (June 9, 1989). In response to a earlier request concerning the necessity of broker-dealer registration in connection with one of these arrangements, the Division of Market Regulation asked for, but did not receive, further information and legal analysis. Maryland Old Line Corp., SEC No-Action Letter, 1976 SEC No-Act. LEXIS 79 (Dec. 13, 1976).

218. Other issues outside the scope of this paper also are raised by these listing services, including whether a listing service should be deemed an investment adviser, *see* Advisers Act § 202, 15 U.S.C. § 80b-2(a)(11) (1988), an exchange, *see* Exchange Act § 6, 15 U.S.C. § 78f (1988), or a securities information processor, *see* Exchange Act § 3(a)(22), 15 U.S.C. § 78c(a)(22) (1988), and therefore subject to other registration requirements. *See* Advisers Act § 203, 15 U.S.C. § 80b-3 (1988); Exchange Act §§ 5, 11A, 15 U.S.C. §§ 78e, 78k-1 (1988).

sale. All negotiations, purchases, and sales occur outside the service. There may be one-time access fees or flat periodic subscription fees.²¹⁹

The services may provide buyers and sellers with historical trade data; however, they may not set the purchase price for securities, match or participate in negotiations between buyers and sellers, or handle their funds or securities.²²⁰ The staff may view these no-action positions as accommodations to the expressed needs of holders of the securities of certain types of issuers. These issuers include limited partnerships, which do not have active secondary trading in their securities and therefore cannot interest a broker-dealer in making a market in the securities.²²¹ Some of the letters expressly state that the listing services will not be publicized²²² or that persons will not be solicited to include their names on the list.²²³

B. Trading Systems

A privately-operated trading system is yet another type of service bringing together buyers and sellers of securities. These systems go beyond merely providing information about indications of interest in buying or selling securities. Rather, they offer their users the capability of completing securities transactions through the systems. The systems thus mimic traditional broker-dealer activity so closely that the staff has been unable to give assurances that it would refrain from recommending enforcement action if the systems did not register as broker-dealers with the Commission.²²⁴

For example, the staff was unable to concur with counsel's opinion that a proposed automated trading information system intended to facilitate secon-

219. See, e.g., Investex Inv. Exch., Inc., SEC No-Action Letter, *supra* note 216; Real Estate Fin. Partnership, SEC No-Action Letter, *supra* note 216. In at least one case, information was provided free of charge. See, e.g., Farmland Indus., SEC No-Action Letter, *supra* note 217.

220. See, e.g., Troy Capital Servs., SEC No-Action Letter, *supra* note 216; Tri-State Livestock Credit Corp., SEC No-Action Letter, *supra* note 217.

221. See, e.g., Troy Capital Servs., SEC No-Action Letter, *supra* note 216.

222. See, e.g., *id.*; CNB Corp., SEC No-Action Letter, *supra* note 217.

223. Farmland Indus., Inc., SEC No-Action Letter, *supra* note 217; Tri-State Livestock Credit Corp., SEC No-Action Letter, *supra* note 217.

224. These systems may raise the same ancillary issues as those raised by listing services. See *supra* note 217; see also Wunsch Auction Sys. Inc., SEC No-Action Letter, [1990-1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,662, at 78,031 (Feb. 28, 1991) (concerning single-price auction system for secondary trading of specified equity and fixed-income securities, utilizing registered broker-dealer); RMJ Sec., SEC No-Action Letter, 1989 SEC No-Act. LEXIS 21 (Jan. 12, 1989) (concerning trading system for over-the-counter options on U.S. Treasury securities utilizing registered government securities broker). The Commission granted the Wunsch single-price auction trading system an exemption from exchange registration on the basis of low volume. Order Granting Limited Volume Exemption from Registration as an Exchange Under Section 5 of the Securities Exchange Act, Exchange Act Release No. 28,899 (Feb. 20, 1991), 56 Fed. Reg. 8377 (Feb. 28, 1991).

dary trading in mortgages among institutions would not be a broker, even though no transaction-based compensation would be paid.²²⁵ Users would enter into the system complete and detailed offers to sell securities, and if a buyer indicated acceptance of the offer, the system would display the transaction as closed.²²⁶ A system to provide a market place for trading oil and gas royalties was also denied a no-action position.²²⁷ The system would effect transactions by matching buyers and sellers, and it would have the discretion to charge a commission.²²⁸

The staff did take a no-action position, however, regarding an electronic information system that would enable its subscribers, which were limited to broker-dealers or their registered representatives, to trade units of registered limited partnerships.²²⁹ After offers to buy and sell a unit had been entered into the system, it would contact the subscriber representing the person with the highest offer and the subscriber representing the seller, and it would act as intermediary between the two parties to close the transaction. The system would clear and settle the transaction and receive a commission from both subscribers. The staff stated that, while the system's proposed activities could require it to register with the Commission as a broker-dealer and in other capacities, requiring registration "could impede the development of innovative systems for trading and settling [trades in] limited partnership interests . . . where careful protections are included to ensure the integrity of customer funds and securities, and all customer contacts occur through a registered broker-dealer or its personnel."²³⁰

225. Schwartz, Kobb, Scheimert, Hammerman & Johnson, SEC No-Action Letter, [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,037, at 83,665 (Feb. 15, 1979).

226. *Id.*

227. National Royalty Exch., SEC No-Action Letter, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,933, at 78,646 (Dec. 21, 1988).

228. *Id.*

229. National Partnership Exch., Inc., SEC No-Action Letter, [1985-1986 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,161, at 76,700 (Aug. 2, 1985).

230. *Id.* The system agreed: (i) to provide quarterly reports to the Commission on its operations; (ii) to give the staff prior written notice of any proposed material changes in its operations; (iii) to submit voluntarily to examination by the Commission; (iv) to maintain a separate bank account for customers' funds, which would be used only to settle customers' transactions; and (v) to obtain a fidelity bond insuring the system against theft by employees of customers' securities or funds. One year later, the system decided to conduct its operations through a registered broker-dealer that it had formed, and the staff modified its no-action position accordingly. National Partnership Exch., Inc., SEC No-Action Letter, 1986 Sec No-Act. LEXIS 260 (July 18, 1986).

VI. CONCLUSION

This paper has examined the purposes and scope of the federal broker-dealer registration requirements as manifested in their application to finders. These finders include persons who refer investors to broker-dealers, to issuers, and to other investors. The application of these requirements to finders ultimately depends on what activities the finders conduct and how they are compensated. Finders who avoid conducting sales efforts, making recommendations about securities, participating in negotiations between buyers and sellers of securities, holding investors' funds or securities, and receiving compensation based, however indirectly, on the outcome of securities transactions resulting from the contact initiated by the finders, can avoid being required by the staff of the Commission to register as broker-dealers.

The staff's flexibility regarding finders may be subject to valid criticism on theoretical, legal grounds. The overriding purposes of the Exchange Act—investor protection and the advancement of the public interest—would appear to support a broad reading of the definition of broker, so that persons acting or holding themselves out as securities professionals may be regulated accordingly. And the Commission itself, in a wide variety of contexts, has read "effecting" transactions broadly. As discussed in this paper, the term can signify much more in the broker-dealer registration context than merely performing the physical acts of exchanging money and securities, so that title to those securities passes from seller or issuer to buyer.

From a practical standpoint, however, elimination of the de facto finder's exception from broker-dealer registration could result in an unwarranted, and perhaps unwanted, expansion of the Commission's regulatory jurisdiction.²³¹ As long as there continues to be no evidence of demonstrated abuses

231. JAFFE, *supra* note 52, § 2.04 at 22. As Jaffe points out:

The careful delineation by the staff of the Commission and other regulatory bodies is not, however, in practice strictly enforced. Most business arrangements involve some transfers of corporate stock and it would be naive at best to assume that the typical businessman acting as a finder simply introduces the parties and then immediately leaves the room so as to be careful not to participate in the negotiations. A careful application of the rules relating to finders would result in numerous enforcement actions and the wholesale registration of businessmen who are unfamiliar with the detailed regulations governing conduct in the brokerage business and who do not engage in the business in any traditional sense. Whether or not there is any necessity for this type of regulation, it is unlikely that the wholesale filings which would ensue upon a strict enforcement of § 3(a)(4) could either be processed by or would be looked upon with favor by the staff of the Commission.

Id.

Finders most assuredly wish to avoid complying with the many detailed statutory and regulatory requirements applicable to broker dealers. In the future, however, there is at least the possibility of a reduced net capital requirement of \$5,000 for registered brokers-dealers that

resulting from the staff's flexible approach, increased regulation of most finders would be neither necessary nor appropriate, despite the fact that they may cross into the realm of broker-dealer activity. Allowing the staff to interpret the broker-dealer registration requirements as they apply to finders on a case-by-case basis is the best way to allow for distinguishing between finders acting as broker-dealers and those not actively engaged in "effecting transactions in securities."

Nevertheless, the activities forbidden to finders help elucidate what it means to be engaged in the business of "effecting transactions in securities," as that phrase is used in the Exchange Act definitions of broker and dealer. Conducting sales efforts, making recommendations about securities, participating in negotiations between buyers and sellers of securities, holding investors' funds or securities, and receiving transaction-based compensation are hallmarks of the broker-dealer. Engaging in any one of these activities may be sufficient to require registration if carried on with any degree of regularity.

It is especially important, both to preserve the exception for legitimate finders and to enforce the broker-dealer registration requirements, that receipt of any compensation based, even indirectly, on the outcome of a securities transaction be limited to regulated securities professionals. Transaction-based compensation is a powerful incentive for unscrupulous finders to effect securities transactions. They may resort to methods of operation deemed by Congress to pose such risks to the public interest and the protection of investors that our present extensive system of federal regulation is the only adequate prophylactic measure.

"do not take customer orders, hold customer funds or securities, or execute customer trades," but "register with the Commission because of the nature of their activities," such as "identify[ing] and locat[ing] potential merger and acquisition opportunities on behalf of a client, and thereby earning a percentage fee." Net Capital Rule, Exchange Act Release No. 27,249 (Sept. 15, 1989), 54 Fed. Reg. 40,395, 40,401 (Oct. 2, 1989).

