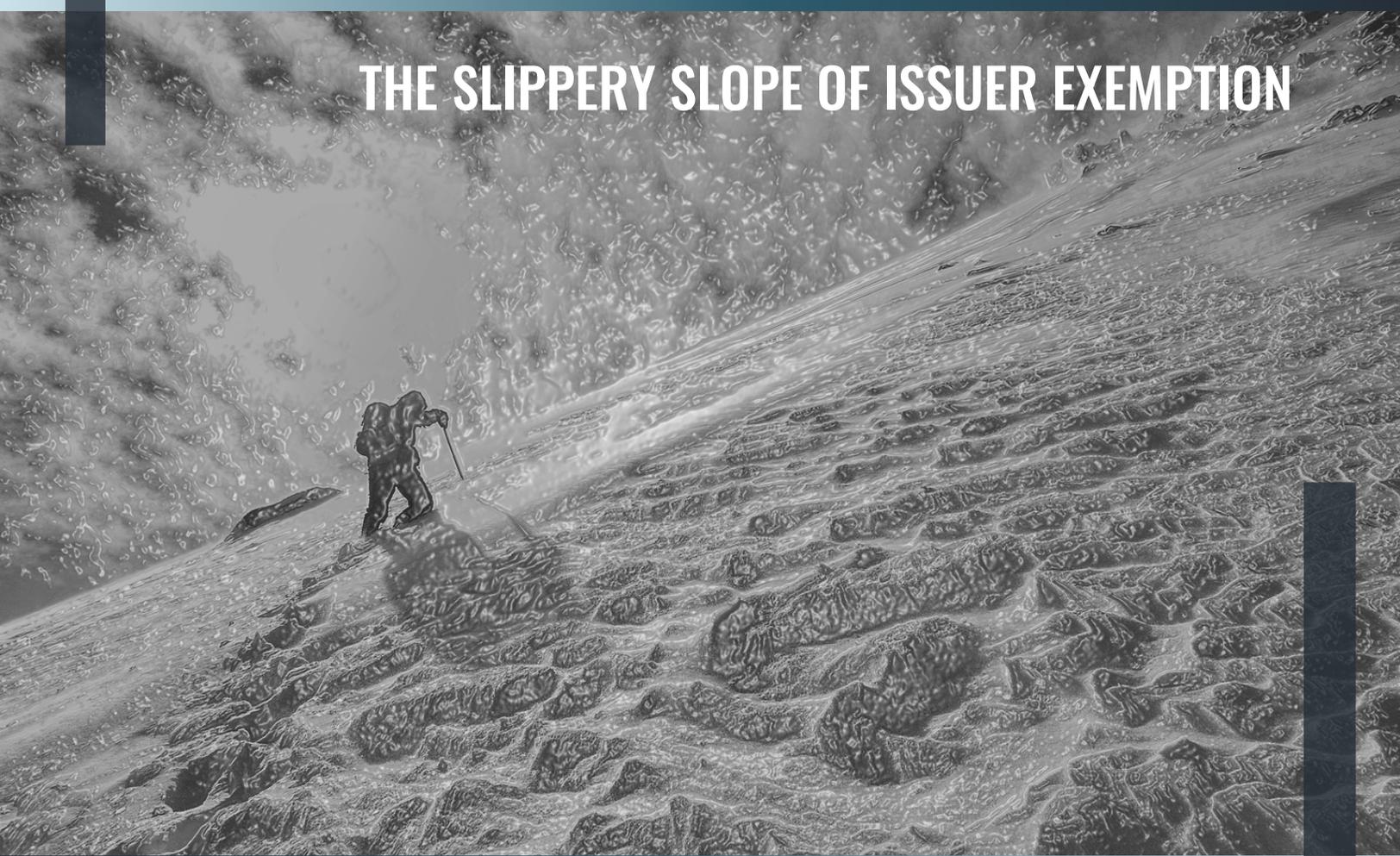


# What Private Fund Managers + Issuers Need to Know

## THE SLIPPERY SLOPE OF ISSUER EXEMPTION



### Authors:

*Mark Fairbanks, Senior Managing Director, Foreside*

*Ralph A. Siciliano, Partner, Tannenbaum, Syracuse & Hirschtritt*



**Tannenbaum Helpern  
Syracuse & Hirschtritt** LLP

For firms that are marketing privately-issued securities, whether as a private fund manager or issuer, ensuring their activity is compliant with FINRA and SEC regulations is essential to avoid costly consequences, both monetarily and from a reputation standpoint. It's important for these firms to remember that regulators like FINRA and the SEC are in place to ensure firms and their employees avoid conflicts of interest, abide by applicable rules and regulations, and act in investors' best interests.

The best way for firms to ensure they are acting in compliance is to educate themselves on the guidelines, issuer exemption eligibility, and potential consequences. We've broken these down into a Q&A, which has been adapted from our webinar, "[Compliance Connections: How to Solicit Private Fund Investors: The BD Rules vs. The Issuer Exemption.](#)"

## Question:

### WHICH INDIVIDUALS REQUIRE BROKER-DEALER REGISTRATION?

*Siciliano:* Law requires that solicitors and entities assisting with solicitation, those involved in investment banking activities, and brokers are required to register as a broker-dealer. This law also applies if for those who conduct securities transactions, are employed by the securities issuer, receive commission-based compensation, recruit investors, and provide advice on investments.

*Fairbanks:* Under SEC's Dodd-Frank Wall Street Reform and Consumer Protection Act, we're seeing many private equity and hedge fund managers evaluate whether their marketing efforts require broker-dealer registration.

*Siciliano:* There are exemptions and exceptions to this rule, but even for lawyers, courts, and SEC/FINRA, it is an unsettled area of regulation, as the courts and the regulators haven't always applied the rules consistently.



## Question:

### WHICH INDIVIDUALS ARE PERMITTED TO MARKET INVESTMENTS WITHOUT BEING A REGISTERED BROKER-DEALER?

*Fairbanks:* Rule 3a4-1, or the "[Safe Harbor Rule](#)" is the most commonly cited exception to broker dealer requirements. It allows a limited group of people who can sell or otherwise promote an unregistered investment fund. This group includes partners, officers, directors, or affiliates.

*Siciliano:* If you've formed the fund as a manager or an employee, you can solicit investors without being registered as a broker-dealer, under certain conditions. If you aren't disqualified from a self-regulatory organization, aren't associated with a broker-dealer, don't receive a commission from the sale and comply with other specific requirements of the exemption, you would be permitted to market investments without broker-dealer registration.

## Question:

### WHAT ACTIONS CAN AN INDIVIDUAL PERFORM IF THEY'RE NOT REGISTERED AS A BROKER-DEALER?

*Siciliano:* Individuals that are not registered as a broker-dealer can only market to a narrow group of financial institutions or financial intermediaries, broker dealers, and banks. The guidelines state that they cannot market to investors, employees' main job cannot be for marketing, and they cannot have offered interests in another fund.



## Question:

### IS IT POSSIBLE TO AVOID THE OBLIGATION TO REGISTER AS A BROKER-DEALER WITHOUT RELYING ON THE RULE 3a4-1 SAFE HARBOR?

*Siciliano:* Courts and regulatory interpretations have recognized certain limited solicitation activities as not requiring registration as a broker-dealer even where the safe harbor rules are not followed. This is the so-called “finder” exception. However, courts and regulators have applied the “finder exception” inconsistently. Take, for example, the famous Paul Anka no-action letter in 1991. In other cases, the individuals solicited investors, forwarded names to a fund, and were paid for doing it. The courts said they didn’t need to register, and their overall activity was fairly limited, which led the courts to conclude that it did not rise to the level of being a broker-dealer.

*Fairbanks:* To stay compliant, it is best to employ one of the following options: (i) use an outside solicitor who is associated with a broker dealer or (ii) use an internal sales team, which may trigger a need for them to register with a broker-dealer.

## Question:

### IS THE BROKER-DEALER EXEMPTION WORTH APPLYING?

*Siciliano:* If you have employees bringing in investors who are paid a salary not related to solicitations, it may be okay. But overall, it’s a very narrow exemption. Employees cannot actively negotiate with prospective investors by introducing, negotiating, delivering materials, discussing risk or strategies.

*Fairbanks:* We’re seeing many advisors of unregistered funds choose to not rely on the exemption because of its stringent requirements. It can be complicated to limit activity sufficiently enough by regulators’ standards.

## Question:

### **HOW CAN ASSOCIATION WITH A FINRA-MEMBER BROKER-DEALER HELP?**

*Fairbanks:* A FINRA-member broker-dealer can serve as an outsource provider that is focused on and experienced with broker-dealer compliance matters. The broker-dealer can provide marketing material review, oversight of registered rep activities, conduct product due diligence and act as a placement agent.

## Question:

### **Q: WHAT ARE THE PENALTIES FOR INDIVIDUALS AND FIRMS THAT VIOLATE THE EXEMPTION?**

*Siciliano:* Individuals and firms that violate the exemption could receive SEC sanctions, fines such as a civil money penalty, and disgorgement of fees plus interest. An example of this is in September 2017, Daniel Caravette was acting as a broker-dealer and had previously registered with broker-dealers in the past but was registered with one at that time and the shares were not exempt from registration. He ended up having to repay fees received, over \$200,000. In March 2013, in the Ranieri Partners LLC case, an investment manager paid commissions to a consultant who was not registered or affiliated with a broker-dealer. The consultant was barred from association with a broker-dealer, but the investment management firm was also sanctioned and required to pay penalties.

*Fairbanks:* In addition to monetary sanctions and/or industry suspensions, that kind of negative impact can be a permanent stain on an individual or firm's reputation.

## Conclusion:

Registering with a broker-dealer, or using a registered broker-dealer, to solicit investors is the best way to ensure compliance for private fund managers or issuers that are unable to rely on the safe harbor. It is not worth the consequences of ignoring if you think you may be exempt or claiming ignorance.

To learn more, listen to Foreside's webinar, "[Compliance Connections: How to Solicit Private Fund Investors: The BD Rules vs. The Issuer Exemption.](#)"

Mark Fairbanks assists in concept, creation and development of products and services that are primarily designed for Foreside's distribution and Broker-Dealer clients.



Ralph A. Siciliano is head of Tannenbaum Helpern's Governmental and Regulatory Investigations practice, as well as represents investment advisors, private funds, broker-dealers and their associated persons.



**Tannenbaum Helpern  
Syracuse & Hirschtritt LLP**