

SEC Charges Finder and Private Equity Firm for Violation of Broker-Dealer Registration

On March 11, 2013, the SEC announced the settlement of charges against a private equity firm, its senior managing partner and an unregistered finder for violations of securities laws when soliciting more than \$500 million in capital commitments for private funds managed by the firm.

Broker-Dealer Registration

Generally, any person “engaged in the business of effecting transactions in securities” is required to be registered with the SEC as a broker-dealer or to be associated with a registered broker-dealer. The Staff historically recognized a “finder exemption” based on the finder’s limited role in certain securities transactions, generally weighing several subjective factors, including:

- *Scope of Services.* The broader the scope of the finder’s participation in the transaction, the more likely the finder will be deemed a broker-dealer.
- *Frequency.* The more frequently the finder engages in such activities, the more likely the finder will be deemed to have effected securities transactions.
- *Custody.* If the finder handles the securities or funds of others in connection with securities transactions, the finder will likely be considered a broker-dealer.
- *Transaction-based Compensation.* Most importantly, when the finder’s compensation is based on the success of the transaction being completed or is based on the size of the transaction, then such finder will likely be deemed a broker-dealer.

Ranieri Partners Matter

The private equity firm, Ranieri Partners, engaged an individual to introduce investors to private funds managed by Ranieri Partners’ affiliates and, in return, received transaction-based compensation totaling approximately \$2.4 million.

The Staff, implying that receiving transaction-based compensation is enough to trigger broker-dealer registration, stated in its press release that the “federal securities laws require that an individual who solicits investments in return for transaction-based compensation be registered as a broker.” However, the Staff also enumerated the finder’s solicitation efforts:

- Sending private placement memoranda, subscription documents, and due diligence materials to potential investors;
- Urging at least one investor to consider adjusting its portfolio allocations to accommodate an investment with Ranieri Partners;
- Providing potential investors with the finder’s analysis of Ranieri Partners’ funds’ strategies and performance track records; and
- Providing potential investors with confidential information relating to the identity of other investors and their capital commitments.

Fund Managers Beware

It is important for fund managers to be aware of the risk of relationships that could be construed as engaging an unregistered broker-dealer. The Ranieri Partners matter highlights some of these risks:

First, the sophistication and wealth of the solicited investor does not mitigate the problem. In Ranieri Partners, the finder solicited sophisticated institutional managers, specifically (i) the Director of Retirement Investments for a private corporation, (ii) the Chief Investment Officer of a university’s endowment fund, and (iii) the Chief Investment Officer of a state retirement system.

Second, penalties were not only sought and obtained against the finder, but also the private equity firm and its senior managing partner. The Staff noted that the firm and its senior managing partner provided the finder with key documents and information related to Ranieri Partners' private equity funds and did not take adequate steps to prevent the finder from having substantive contacts with potential investors.

Should you have any questions, please feel free to contact us:

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