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The Friend Who Wants a Cut

Why Paying Unregistered "Finders" in Regulation D Offerings Triggers Rescission, Bad-Actor Disqualification, and SEC Enforcement — A Plain-English Guide for Issuers

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At a Glance: The Friend-Who-Wants-a-Cut Problem

- **Transaction-based compensation — any fee tied to whether or how much an investor subscribes — is the single clearest hallmark of unlawful unregistered broker activity.**
- The legal exposure falls on the *issuer*, not just the finder: rescission under Section 29(b), loss of the Rule 506 exemption, and anti-fraud liability.
- The familiar "safe harbors" (the Paul Anka letter, Rule 3a4-1, the M&A broker exemption) do not rescue a friend-with-a-network arrangement in a Reg D raise.
- There is no drafting fix. The only compliant paths are to engage a registered broker-dealer, use Rule 3a4-1 properly for issuer personnel, or decline the arrangement.

It happens in nearly every Regulation D offering. A sponsor is mid-raise, the timeline is tight, and a friendly contact — an existing investor, an old business associate, a consultant who "knows everyone" — offers to help. "I know plenty of accredited people," the friend says. "I'll make introductions. I just want a small piece of what comes in." Sometimes the friend will invest, too. But somewhere in the conversation is always the request for a cut.

The instinct is to accept. The friend is well-connected, the timeline is short, and a commission paid only on capital actually raised feels like aligned incentives. But unless the friend is registered as a broker-dealer (or is a registered representative of one), almost every variation of that arrangement violates Section 15(a) of the Securities Exchange Act of 1934.[1] The consequences fall not only on the finder, but on the issuer that paid him: investor rescission rights, Rule 506(d) Bad-Actor disqualification of the entire offering, and SEC enforcement. This Alert explains the rule, the safe harbors that almost never apply in a Regulation D raise, and the practical guardrails every issuer should observe.

The Practice

The scenario takes recognizable forms. A prospective investor agrees to subscribe — but only if he is paid a percentage of whatever his friends invest. A consultant offers to circulate the offering memorandum to "his people" in exchange for a success fee tied to the dollars raised. A retired finance professional asks for a referral fee for every accredited investor he introduces who ultimately subscribes. A real estate professional pitches the deal to country-club members in exchange for a percentage of the equity raised.

In each case, the central feature is the same: the intermediary is not registered with the SEC or any state as a broker-dealer, is not associated with a registered firm, and expects compensation that depends on the success of the securities offering. That single feature — transaction-based compensation paid to an unregistered intermediary — is what makes the arrangement unlawful, regardless of how the parties label it.

The Rule: Section 15(a) and What It Means to Be a "Broker"

Section 15(a) of the Exchange Act makes it unlawful for any broker to use the mails or any means of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security unless the broker is registered with the SEC.[1] Section 3(a)(4) defines a "broker," with deceptive simplicity, as "any person engaged in the business of effecting transactions in securities for the account of others."[2] The Commission and the courts have read each of the operative words — *engaged*, *in the business*, and *effecting transactions* — broadly. There is no de minimis exception, no "one-time" exemption, and no "introducer" carve-out.

The SEC has long identified a series of hallmarks that, taken together, indicate that a person is acting as a broker. The most important of these — and very often dispositive on its own — is the receipt of **transaction-based compensation**, i.e., compensation that varies with the success of the securities sale.[3] The Commission reaffirmed this position in a series of 2025 enforcement settlements, where it treated transaction-based compensation — in one matter, even heavily discounted shares rather than cash — as the key element of the violation.[4]

The Hallmarks of Unregistered Broker Activity

- Receiving **transaction-based compensation** (a fee that varies with the success or size of the sale).
- Actively soliciting or recruiting investors.
- Participating in negotiations over price or terms.
- Providing advice on the merits or valuation of the investment.
- Handling investor funds, securities, or subscription documents.
- A regular pattern of participation across offerings — evidence of being "engaged in the business."

The Safe Harbors That Almost Never Help

Sponsors and their proposed finders frequently invoke three exceptions. None of them rescues the typical "friend-with-a-network" arrangement in a Regulation D offering.

The Paul Anka Letter — a museum piece, not a roadmap

The most famous "finder" no-action letter is *Paul Anka*, issued in 1991. The entertainer was permitted to receive a fee for furnishing a list of accredited acquaintances to an issuer, on the express premises that he would not solicit, recommend, negotiate, or otherwise participate in the offering.[5] The Commission staff has consistently refused to extend that relief since. The 2010 *Brumberg, Mackey & Wall* letter made the staff's current view explicit: transaction-based compensation paid to an unregistered intermediary ordinarily requires broker-dealer registration, full stop.[6] *Paul Anka* is best read as a footnote in compliance history, not a template.

Rule 3a4-1 — for issuer personnel, not friends

Rule 3a4-1 provides a safe harbor under which certain associated persons of the issuer (typically officers, directors, or employees) may participate in the sale of the issuer's own securities without registering as brokers.[7] The conditions are unforgiving. The person must not, among other things, receive any commission or other transaction-based compensation in connection with the sale; must not have been a broker-dealer within the prior twelve months; and must perform substantial duties for the issuer other than in connection with securities transactions. A "friend" who is paid a percentage of the raise meets none of these conditions and is, by definition, outside the safe harbor.

The M&A Broker Exemption — wrong statute, wrong transaction

The federal M&A broker exemption — codified at Section 15(b)(13) of the Exchange Act and effective March 29, 2023 — permits unregistered intermediaries to facilitate certain sales of privately-held operating companies.[8] It does not apply to capital-raising. A Regulation D offering of fund interests, preferred equity, or membership interests in a single-asset LLC is outside the exemption's scope. Citing it in the context of a finder arrangement is a category error.

> *If the friend will be paid a percentage of the raise — or any fee that varies with the success of the offering — and is not registered as a broker-dealer, the arrangement is unlawful. There is no contract drafting that saves it.*

Three Risks That Fall on the Issuer

The popular mistake is to assume that the registration failure is the finder's problem. It is not. Each of the following consequences attaches to the issuer and, in many cases, to its principals.

Three Risks That Fall on the Issuer

- **Section 29(b) rescission:** the investor can void the subscription and recover principal with interest.
- **Rule 506(d) bad-actor disqualification:** the federal exemption for the entire offering can evaporate.
- **Anti-fraud exposure:** the undisclosed finder arrangement may itself be a material omission.

1. Section 29(b) Rescission — the investor can unwind the trade

Section 29(b) of the Exchange Act renders every contract "made in violation of" the Act — including violations of Section 15(a) — voidable at the election of the party prejudiced by the violation.[9] Where an issuer has paid an unregistered finder a transaction-based fee to procure a particular subscription, the resulting subscription agreement is itself "made in violation of" the Act, and the investor may elect to rescind, recover his principal with interest, and walk away. The remedy is statutory; the investor need not prove fraud or reliance. For a sponsor whose capital has already been deployed into real estate, an operating business, or a portfolio of loans, the prospect of a wave of rescission claims is precisely the kind of catastrophe that no insurance product covers.

2. Rule 506(d) Bad-Actor Disqualification — the safe harbor evaporates

Rule 506(d) disqualifies an offering from the Rule 506 safe harbor if any "covered person" — a category that expressly includes any compensated solicitor of investors — has experienced a disqualifying event.[10] A compensated solicitor includes the unregistered finder. If the finder is later the subject of an SEC order, a court injunction, or a state regulator's bar in connection with the unregistered activity — results that the SEC routinely seeks against such finders — the disqualification reaches back to taint the offering itself. The issuer's federal exemption disappears; the resulting unregistered sale of securities is a Section 5 violation; and the rescission and damages exposure scales with the size of the raise.

3. Anti-Fraud Exposure — the omission is itself material

Even setting aside the registration question, the issuer's failure to disclose to its investors that a non-registered intermediary has been paid commissions in connection with the offering may itself be a material omission actionable under Section 17(a) of the Securities Act and Rule 10b-5.[11] Investors expect that the persons soliciting them are subject to a regulated standard of conduct. The identity, compensation, and registration status of those persons are precisely the kinds of facts that a reasonable investor would consider important.

Whether the PPM is silent on the arrangement or describes it inaccurately, the issuer's exposure is independent of and additional to the Section 15(a) problem.

The State-Law Layer

Federal preemption under NSMIA applies to the registration of the securities themselves, not to the registration of the persons selling them.[12] Every state in which the issuer's offering is sold has its own broker-dealer registration regime, its own definition of "broker," and its own civil liability provisions for sales effected by unregistered persons. A finder arrangement that fails the federal test will fail nearly every state test as well, and several states impose direct rescission and damages rights in favor of the investor against the issuer.

Practical Red Flags

Counsel and sponsors should treat any of the following as presumptively indicative of an unregistered broker arrangement until the contrary is established in writing:

- Compensation — in any form — that varies with whether, or how much, the introduced investor subscribes.
- A "flat" fee that is, on inspection, calculated as a percentage of the raise, denominated in equity, or paid only if the offering closes.
- Active solicitation by the intermediary: sending the PPM, walking through the investment thesis, soliciting subscriptions, fielding investor questions, or negotiating terms.
- Any handling of investor funds, subscription documents, or wire instructions by the intermediary.
- A pattern of involvement across multiple offerings or multiple issuers — in itself evidence of being "engaged in the business."
- Marketing the intermediary's role to investors as a "placement agent," "capital advisor," "finder," or similar title.

The Path Forward

There is no creative drafting that saves a transaction-based finder arrangement with an unregistered intermediary in a Regulation D offering. The practical answers are three:

1. **Engage a registered broker-dealer.** If outside marketing is desired, retain a FINRA-registered broker-dealer under a written placement agreement, disclose the engagement and the compensation in the PPM, and confirm the Bad-Actor screen.
2. **Use the Rule 3a4-1 safe harbor properly.** Issuer principals and employees may participate in the offering, but only on a salary basis and consistent with every condition of Rule 3a4-1 — no transaction-based component, however dressed.
3. **Decline the arrangement.** Where a "friend" insists on a commission, the right answer is no. The conversation is best had at the outset, in writing, ideally over the signature of counsel.

The Bottom Line

The unregistered-finder problem is among the most consistently mis-managed risks in private capital raising. The arrangement is easy to set up, the dollars at stake feel small, and the parties' intentions are usually benign. The regulatory regime does not care. Section 15(a) is a strict-liability rule for the unregistered person and a cascade of secondary consequences for the issuer. Sponsors building a Regulation D offering should treat any proposed compensation tied to capital raised — in any form, payable to anyone — as a question for counsel before, not after, the first introduction is made.

> *The right time to address the friend-who-wants-a-cut conversation is at the beginning of the raise, before the first email goes out — not after the first subscription wires in.*

The Compliance Checklist — Before the First Intro

Every Regulation D sponsor should run through the following gate before paying any third party for help with a raise:

1. Is the intermediary registered as a broker-dealer with the SEC and FINRA, or registered as a representative of one? Verify on BrokerCheck.
2. Will any element of the compensation — cash, equity, expense reimbursement, future allocations — vary with whether, or how much, the introduced investor subscribes?
3. Has the intermediary been screened against the Rule 506(d) Bad-Actor disqualifications, and has a signed Bad-Actor questionnaire been added to the closing binder?
4. Will the intermediary be soliciting, negotiating, handling investor funds, or distributing the PPM — any of which is broker activity?
5. If the proposed role is for an issuer employee or officer, does the arrangement satisfy every condition of Rule 3a4-1, including the no-commission requirement?
6. Has the compensation arrangement been disclosed in the PPM — accurately, completely, and consistent with the marketing materials?
7. Has each state in which an introduced investor resides been screened for its own broker-dealer registration and finder-fee rules?

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Endnotes

1. Securities Exchange Act of 1934 § 15(a), 15 U.S.C. § 78o(a).
2. Securities Exchange Act of 1934 § 3(a)(4), 15 U.S.C. § 78c(a)(4) (definition of "broker").
3. See SEC, Guide to Broker-Dealer Registration (Apr. 2008), https://www.sec.gov/about/divisions-offices/division-trading-markets/division-trading-markets-compliance-guides/guide-broker-dealer-registration (receipt of transaction-based compensation is a hallmark of broker-dealer activity).
4. See, e.g., Wilson Sonsini, "No Commission Without Permission: SEC Reinforces Focus on Transaction-Based Compensation" (Mar. 2025), https://www.wsgr.com/en/insights/no-commission-without-permission-sec-reinforces-focus-on-sales-activities-and-transaction-based-compensation-as-hallmarks-of-broker-dealer-status-in-recent-settlements.html (collecting 2025 settlements).
5. Paul Anka, SEC No-Action Letter, 1991 WL 176891 (July 24, 1991).
6. Brumberg, Mackey & Wall, P.L.C., SEC No-Action Letter (May 17, 2010), https://www.sec.gov/divisions/marketreg/mr-noaction/2010/brumbergmackey051710.pdf.
7. 17 C.F.R. § 240.3a4-1 (safe harbor for associated persons of an issuer).
8. Securities Exchange Act of 1934 § 15(b)(13), 15 U.S.C. § 78o(b)(13) (federal M&A broker exemption, added by the Consolidated Appropriations Act, 2023, effective Mar. 29, 2023).
9. Securities Exchange Act of 1934 § 29(b), 15 U.S.C. § 78cc(b).
10. 17 C.F.R. § 230.506(d) ("bad actor" disqualification; "covered persons" include any compensated solicitor of investors). See SEC, Bad Actor Disqualification compliance guidance, https://www.sec.gov/resources-small-businesses/small-business-compliance-guides/disqualification-felons-other-bad-actors-rule-506-offerings-related-disclosure-requirements.
11. Securities Act of 1933 § 17(a), 15 U.S.C. § 77q(a); 17 C.F.R. § 240.10b-5.
12. National Securities Markets Improvement Act of 1996 (NSMIA); see Securities Act § 18, 15 U.S.C. § 77r (preemption of state registration of covered securities, not of persons effecting transactions).