Public Investors Arbitration Bar Association

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Via Email Only
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curren.price@sen.ca.gov

Senator Juan Vargas
Chair, Senate Banking and Financial Institutions Committee
State Capitol, Room 3092
Sacramento, California 95814

Senator Curren Price
Chair, Senate Business, Professions & Economic Development Committee
State Capitol, Room 2057
Sacramento, California 95814

Re: SB 978 (VARGAS and PRICE) – SUPPORT

Dear Senators Vargas and Price:

The Public Investors Arbitration Bar Association (PIABA) is a national association of more than 400 attorneys that represent victims of investment fraud including stockbroker and financial planner misconduct. PIABA members represent investors who have suffered devastating losses resulting from violations of laws and other regulations that govern the securities industry in an effort to protect investors. Disproportionately, these financial losses fall on the elderly and other vulnerable savers and investors.

Sadly, deregulation of securities offerings and financial services coupled with rollbacks in investor protection at the federal level have created an incubator for malfeasance during the most recent real estate boom and bust cycle. PIABA believes that protecting offerees and purchasers of investments in hard-money real estate loans and other real estate securities is a step in the right direction that serves to better protect the investing public and will improve the honesty and transparency of this segment of California's financial markets.

PIABA supports the availability of loans and capital to those who need it – but not at the risk of harming investors who do not understand what they are getting into or for whom the investments are otherwise unsuitable or impose risks beyond their risk tolerance or investment objectives.

SB 978 will improve investor protection in several ways. One, discussed at Item 2 of the Background Information Sheet, is the requirement that offerors and sellers of real estate securities file more detailed information with the Department of Corporations (the "Department"). The Department is the local cop on the beat and likely the only protection for many investors. Providing the Department with the information it needs to be able to do its job in this problematic area of investor protection is fundamental and should not be a matter for debate.

As discussed at Item 4 of the Background Information Sheet, SB 978 also will give investors in single-lender hard-money real estate loans the same protections currently enjoyed by investors in multi-lender hard money real estate loans. There is simply no reason why single investors should have less protection than participants in a multiple-lender loan. Indeed, the amount invested by a single investor will, by definition, fund the entire loan. Thus, the amount that the investor places at risk in a single loan often will be greater than the sum that participants in multiple-lender loans place at risk.

Perhaps the most important improvement to be brought about by SB 978 is the one discussed at Item 5 of the Background Information Sheet: a suitability requirement for investors in hard-money loans. The idea that an investor, particularly an elderly or retired investor, might put more than 10% of his or her net worth into a hard-money loan is shocking. The fact that this is going on is proof that the law needs revision.

In the current market especially, with interest rates on savings at all-time lows, large numbers of seniors and retirees are particularly vulnerable to promises of higher returns. They can compare the promised returns because the numbers can be stated, plain as day. What isn't clear or easy for these unsophisticated investors to quantify is the difference in risk. And the money they lose is, all too often, unrecoverable. They suffer not just financially but emotionally and physically as well when they lose the nest-egg that they have accumulated over a lifetime. To be put at that kind of risk so that their capital can be turned into raw material for promoters of high-risk, hard-money real estate loans is grossly inappropriate.

PIABA believes that money lost by investors in what prove to be bad hard-money loans is likely never to be recovered. To the extent that part of what made the loan unattractive to banks and other traditional lenders in the first place was concern about the security for the loan, a foreclosure or trustee's sale may yield insufficient sums to make the lenders whole.

PIABA has seen the opposition to SB 978 and disagrees with certain of its assertions. The opposition asserts, for example, that the bill is "over-inclusive" because it regulates all real estate securities and not just securities backed by hard-money loans. What the objection misses is that real estate securities *as a whole* are responsible for a third of all of the Department's enforcement actions since 2009. While hard-money loans are a serious problem, they are not the only problem. Many PIABA members have seen the damage inflicted on investors by all kinds of real estate offerings, including both equity programs and debt programs. The scope

of SB 978 is appropriate. Restricting it to debt-based programs would be an unfortunate narrowing of the investor protections contained in the bill.

The opposition also seeks to eliminate oversight of offers of real estate securities and to limit the regulation to sales. That could have the effect of preventing the Department from protecting investors before the harm occurs and limiting it to trying to undo harm that already has been inflicted. There is a reason why securities laws have, from their early days, regulated *offers and sales* of securities. A weakening of that longstanding pillar of investor protection would be inappropriate.

Further, the opposition asserts that two phrases in section 5 the bill (proposed Corporations Code section 25102.2(a)), addressing additional information required to be provided in these offerings, are unclear. Both of the allegedly unclear phrases appear and are italicized in the following quote:

> ". . . a list of all state and federal licenses required to *further the purposes of the investment*, and the names of all licensed persons that will undertake *those activities*."

PIABA believes that the phrases are clear and do not require revision.

Finally, the opposition seeks to replace the 10 CCR 260.140.212.2 suitability standard expressly applicable to real estate programs with the far weaker 10 CCR 260.218.2 standard applicable to broker-dealers. PIABA views this additional proposed weakening of investor protections to be unjustified and inappropriate. The primary impact of the proposed change will be to strengthen the legal defenses of promoters that make inappropriate sales of real estate securities and to embolden them to make those sales given the lower risk that they will be held accountable. The investors, often elderly, who are approached with offerings of these kinds of securities need the protections afforded by the stronger suitability standard.

We as a people have a long history of learning and relearning the harsh lessons of the past. We are being battered mercilessly this time around for forgetting repeated lessons about the dangers financial industry deregulation, including the lessons of the 1920s and 1930s. Continuing efforts at further deregulation of financial and securities markets should be resisted. We instead should remember and move back toward the regulatory environment that, for the approximately six decades that ended in the mid-1990s, imbued U.S. capital markets with a level of honesty and transparency that made them the envy of the world. And closer to home, SB 978 affords us an excellent opportunity to improve that honesty and transparency for California's savers and investors, and for seniors and retirees in particular.

Thank you for your consideration of our views on this important bill.

Very truly yours,

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