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April 26, 2023

Chairman Patrick McHenry
Ranking Member Maxine Waters
U.S. House Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

Re: Pending Bills Before the HFSC set to Expand Access to Private Investments and Unregistered Securities

Dear Chairman McHenry and Ranking Member Waters:

The Public Investors Advocate Bar Association (PIABA)[1] appreciates the opportunity to submit this letter relating to legislation that is currently pending before the House Financial Services Committee.

PIABA appreciates the interest in expanding access to private investment to a broader swath of Americans. The unfortunate reality is, repeatedly over history, private investments and unregistered securities victimize retail investors on an ever growing basis. It would be a potentially grave mistake for many retail investors if these many bills are passed into law without a scintilla of investor protection measures. As written, these bills seek to greatly expand the definition of "accredited investor" without adding any corollary language requiring certain safeguards be put in place by the Securities and Exchange Commission (SEC) to ensure proper governance and oversight.

At the outset, it is important to realize the accredited investor standard is imperfect and has faced criticism for years.[2] The SEC's reliance on financial thresholds implies that wealthy

[1] PIABA is an international bar association comprised of attorneys who represent investors in securities arbitrations. Since its formation in 1990, PIABA has promoted the interests of the public investor in all securities and commodities arbitration forums, while also advocating for public education regarding investment fraud and industry misconduct. Our members and their clients have a strong interest in rules which govern the conduct of those who provide advice to investors.

[2] Thomas M. Selman, *Protecting Retail Investors: A New Exemption for Private Securities Offerings*, 14 Va. L. & Bus. Rev. 41 (2020); Wallis K. Finger, *Unsophisticated Wealth: Reconsidering the SEC's "Accredited Investor" Definition Under the 1933 Act*, 86 WASH. U. L. REV. 733 (2009); Howard M. Friedman, *On Being Rich, Accredited, and Undiversified: The Lacunae in Contemporary Securities Regulation*, 47 OKLA. L. REV. 291 (1994); *Syed Haq, Revisiting the Accredited Investor Standard*, 5 MICH. BUS. & ENTREPRENEURIAL L. REV.

investors possess the appropriate level of financial sophistication to assess private market offerings without needing to rely on mandated disclosures. Wealth, however, does not translate to investment acumen. Despite their considerable wealth and financial sophistication, many venture capital investors have fallen victim to private offering security frauds.

Several bills in markup before the Committee seek to amend the accredited investor standard based on experience and acumen. In some instances, like amending the definition to include those individuals who are licensed financial advisors, makes sense. Other Bills seeking to expand the definition, however, will have a seriously negative impact on retail investor protection.

I. Current Bills in Mark-Up That Will Grossly Increase Fraud and Manipulation of Retail Investor Savings

a. PIABA Opposes Any Effort To Expand the Definition of "Accredited Investor" to Include Any Purchaser who is Solicited By an Investment Professional

The first bill which PIABA finds particularly troubling, expands the definition of "accredited investor" to include:

> any individual receiving individualized investment advice or individualized investment recommendations with respect to the applicable transaction from an individual described under section 203.501(a)(10) of title 17, Code of Federal Regulations.

This bill assumes that "an individual described under section 203.501(a)(10) of Title 17, CRF", has only made the recommendation in keeping with his or her fiduciary obligations as set forth in the Investment Advisers Act of 1940. In a perfect world that would be the case. The reality is private investments and unregistered securities actually represent a substantial percentage of all retail-investor related customer complaints and frauds. According to the North American Securities Administrators Association (NASAA), in 2020, of the 595 investigations launched by state securities regulators, over 30% involved "unregistered securities", the largest of any single other investment type, and more than "traditional securities."[3] Statistics maintained by FINRA Dispute Resolution indicate that, in 2021, filed customer complaints which identify "limited partnerships" and "private equities" as being the investments at issue represent over 10% of

59 (2015); Gregg Oguss, *Should Size or Wealth Equal Sophistication in Federal Securities Laws?,* 107 NW. U. L. REV. 285 (2012).

[3] https://www.nasaa.org/wp-content/uploads/2021/09/2021-Enforcement-Report-Based-on-2020-Data-FINAL.pdf

investor complaints filed. The amount increases to over 33% if other "alternative investments" like non-traded Real Estate Investment Trusts and Business Development Corporations, are included.[4]

Under the current regulatory regime, access to private investments and unregistered securities is a substantial problem for retail investors. Under the proposed expanded regime, that problem will only get worse.

b. PIABA Opposes the Unlocking Capital for Small Businesses Act of 2023

The second proposed bill that PIABA opposes is the Unlocking Capital for Small Businesses Act for 2023. This law, if passed, would provide a safe harbor for private placement brokers and finders. This bill expands protections to "finders" of private investment and unregistered securities and allows them to earn substantial "finders fees" for their sales efforts. Despite any number of problems with this proposed bill, there is minimal language, beyond routine disclosures and a promise that the finders won't actively solicit investors, that either the SEC or the Congress considers for the protection of retail investors. By their nature, private investments lack the same level of disclosure information that securities subject to the strictures of public markets are mandated to provide. By their nature, they lack the requisite public market scrutiny of business plans and models, likelihood of success, routine background information, site visits, audited financial statements, and any other common due diligence obligations required of every publicly sold security. Allowing unlicensed and untrained "sellers" to broadly solicit the sale of this category of private investments to an even larger populace of retail investors is a catastrophe in the making.

The Act allows non-registered finders to accept transaction-based compensation—up to $500,000 per year—for directing accredited investors to private placement deals. Yes, the Finders are still not supposed to "solicit" investments, but with incentives potentially that lucrative, it is difficult to think that an un-registered Finder will show much restraint. No doubt, investors will also view the presentations by these Finders as being endorsements for the products that are being peddled.

This bill revises the regulatory treatment of Private-Placement Brokers (brokers who receive transaction-based compensation for the sale of exempt securities for introducing an issuer and a buyer) and Finders (non-registered private-placement brokers who do not exceed a specified amount of compensation ($500,000 per year), transaction value (< 15MM per transaction per year or < 30MM per year total), or number of transactions in a year (< 16 per year).

Specifically, the bill:

[4] https://www.finra.org/arbitration-mediation/dispute-resolution-statistics#top15securitycustomers

(1) requires the Securities and Exchange Commission to establish registration requirements for Private-Placement Brokers that are no more stringent than those imposed on crowdfunding portals,

(2) allows for membership in any national securities association for private-placement brokers,

(3) requires that the Private Placement Broker disclose that they are acting as a Private Placement Broker, the amount of anticipated compensation, the person to whom the payment is made, and any beneficial interest in the issuer.

PIABA opposes passage of this bill which allows untrained and unqualified "finders" to solicit retail investors to invest in the most speculative, opaque, and illiquid securities in the marketplace.

c. The Private Investment Marketplace is a Hot Bed for Fraud That Impacts Retail Investors

The effort to expand the reach of private placements to a wider swath of Americans must be viewed in light of the ongoing issues with such products. Simply put, private placements and unregistered securities make up a substantial percentage of reported investor complaints. Consider Americans' experience in 2021 alone. In February 2021, the SEC charged GPB Capital Holdings, LLC, and other defendants with operating a "long running and multi-faceted scheme" which defrauded investors out of almost $1 billion.[5] The United States Attorney for the Eastern District of New York brought criminal charges in 2021 and the defendants are awaiting trial. The investors GPB targeted to raise capital were retail investors. GPB used a network of over sixty broker/dealers and registered investment advisers to reach the pockets of retired and financial unsophisticated investors.

The year also featured two instances in which Texas-based private investments ruined the retirement of hundreds of retail investors: The DeepRoot Funds and Heartland Capital scandals. Both of these entities used unregistered "finders," or RIAs, to sell private equity interests in these companies to retail investors across the country.[6] Both ended up in liquidation amid SEC and Department of Justice allegations of securities fraud and have collectively cost retail investors about $150 million. Litigation poised to recover these funds from these "finders" usually goes nowhere because they are uncollectable and carry no viable liability insurance coverage. These problems for retail investors are compounding and the newsreel is filled with similar stories almost daily.

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[5] *Securities and Exchange Commission v. GPB Capital, et al.,* 21-cv-00583 (E.D.N.Y.)

[6] *Securities and Exchange Commission v. Robert J. Mueller, DeepRoot Funds, LLC, and Policy Services, Inc.* 21-cv-00785 (W.D. Tex.); *and Securities and Exchange Commission v. The Heartland Group Ventures, LLC, et al;* 21-cv-01310 (N.D. Tex.).

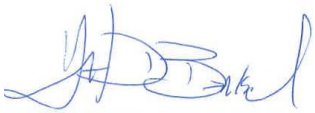
d. Numerous Bills Pending Markup which Expands the definition of Accredited Investor Must Also include Mandates from the Congress to the SEC to properly regulate.

There are six bills pending markup in your Committee which, in one way or another, expand the definition of Accredited Investor and as such expand access to this market. PIABA believes the passage of these Bills should be dependent upon additional language requiring the SEC to study the following issues in connection with retail investor complaints against RIAs generally.

1) Require the SEC to study the number of investor complaints filed against RIAs that involve private securities;
2) Require the SEC to study and make available a report about the outcomes of these cases to determine success rates and collectability of any awards or judgments;
3) Require the SEC to study RIA disclosure of customer complaints;
4) Require the SEC to study whether RIAs are abusing the private arbitration process; and,
5) Require the SED to study, and to require the disclosure of, liability insurance maintained by RIAs who solicit investors to purchase private securities.

If the Congress is intent on expanding access to private securities, it must include some measure of oversight to ensure the SEC is cognizant of the serious issues faced by retail investors by RIAs. The bills, if passed without such strictures, will expose countless Boomers who are retiring in record numbers and susceptible to compelling sales pitches to invest (and ultimately lose) their irreplaceable 401K funds. PIABA does not believe it best for Congress to facilitate those hard-working Americans' need to turn to public social services after their retirement funds have been depleted by unscrupulous and unregulated financial professionals.

Very Truly Yours,



Hugh Berkson
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