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May 2, 2023

Via Electronic Mail
The Honorable Speaker Steve Yeager
The Honorable Senator Melanie Scheible
Chair, Senate Judiciary and Speaker, Nevada Assembly
401 S. Carson Street
Carson City, Nevada 89701
Via: SenJUD@sen.state.nv.us
Steve.Yeager@asm.state.nv.us

Re: Assembly Bill 75

Dear Speaker Yeager, Chair Scheible, and Members of the Senate Judiciary Committee,

I write on behalf of the Public Investors Advocate Bar Association ("PIABA"), an international, not-for-profit, voluntary bar association that consists of attorneys who represent investors in disputes with the securities industry. Since its formation in 1990, PIABA's mission has been to promote the interests of the public investor by, among other things, seeking to protect investors from falling prey to investment fraud, and advocating for public education related to investment fraud and industry misconduct. Our members and their clients have a fundamental interest in the laws promulgated by the Nevada legislature relating to exempt offerings in private markets.

Thank you for the opportunity to express our concerns with Nevada Assembly Bill 75 ("AB75"). As now proposed to be amended, AB75 would create an intrastate offering exemption which would allow issuers with no operating history, no audited financials, and no meaningful prospect of success to sidestep federal and state securities laws and sell illiquid private offerings to Nevadans earning at least $100,000.[1] AB75 proposes to allow sellers to solicit and obtain up to 10% of Nevadan's net worth (including 50% of the value of a person's home) on a per-transaction basis in these investments.

While the recent proposed amendment raises the income limit, this provision will shield some Nevadans for only a limited time. Without any indexing for inflation, the lasting impact of this increase will quickly diminish as the state income level approaches the new threshold.

[1] Illiquidity in financial markets refers to investor's limited ability to sell their investment stake due to limited access to markets of willing buyers.

If passed, this legislation would threaten Nevadans' financial security and open the door to substantial fraud and abuse. For the reasons set forth below, we urge you to reject this legislation.

I. Securities Laws Provide Important Protections.

Public markets play an important role in the American economy. American issuers now have access to the world's largest and most well-developed capital markets. These markets allow businesses to raise capital and main-street Americans to save for retirement.

Investors benefit from public markets. If companies want to raise money from the public, securities laws require disclosure about the company's finances, governance, and operations. Market participants use this information to compare potential investment opportunities and to efficiently allocate their capital across the economy.

Public markets have thrived over the years because they instill trust and accountability amongst all participants. Businesses and their representatives conduct due diligence to ensure they provide accurate and complete information when they register new securities. In return, investors part with their hard-earned funds with the assumption that the information they receive has been properly scrutinized. Historically, public policy has favored this approach.[2] However, there has been a recent push to lower registration requirements and increase access to private markets. Yet private market offerings do not provide clear and uniform information to the public. This undercuts public markets and ultimately investors' interests.

AB75's proposed amendment lowers the standard for new securities registering with the state.[3] The amendment deviates from the enacting legislature's previously stated intent to direct stricter state attention to offerings that were not already federally registered.[4] While the proposed changes make it easier to issue new securities, they ignore the importance of maintaining the high standard of review that has promoted both public market success and investor protection.

II. Private Market Offerings Undermine the Benefits of Public Markets and Eliminate the Protections Individual Investors Rely Upon.

Congress and the SEC's expansion of exempt securities offerings has expanded private markets at an unprecedented rate. In fact, the number of exempt offerings has surpassed that of

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[2] North American Securities Administrators Association (NASAA), *Report and Recommendations for Reinvigorating our Capital Markets* (February 7, 2023), https://www.nasaa.org/wp-content/uploads/2023/02/NASAA-Report-and-Recommendations-on-Reinvigorating-Our-Capital-Markets-2.7.23-Final.pdf. [Hereinafter "NASAA Report"].

[3] NEV.REV.STAT. § 490.091.

[4] Minutes of the Assemb. Comm. on Com., Leg., 64th Sess. (Nev. 1987) https://www.leg.state.nv.us/Division/Research/Library/LegHistory/LHs/1987/AB457,1987.pdf.

public offerings in recent years.[5] Unfortunately, the federal standard governing individual's access to risky private offerings leaves much to be desired.

The most substantial federal exemption, Regulation D, was designed "to simplify and clarify existing exemptions, to expand their availability, and to achieve uniformity between federal and state exemptions in order to facilitate capital formation consistent with the protection of investors."[6] Under Regulation D, individual investors must qualify as an "accredited investor," to participate in exempt private market offerings. The accredited investor standard aims to identify investors who possess the financial sophistication to evaluate the merits of private financial offerings and have the ability to bear the economic risk of the investment.[7] To qualify, an individual investor must either have a net worth of at least $1 million, excluding the value of their primary residence, or have an income above $200,000.[8]

The federal accredited investor standard has garnered considerable criticism.[9] The SEC's reliance on financial thresholds implies that wealthy 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. Professor Fletcher, in her letter to the Assembly, put it aptly: "No amount of wealth or sophistication is a substitute for robust securities laws that provide all investors with the information needed to make informed investment decisions."[10]

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[5] SEC, Report to Congress on Regulation A / Regulation D Performance As Directed by the House Committee on Appropriations in H.R. Rept. No. 116-122 (Aug. 2020) at 41, https://www.sec.gov/files/report-congress-regulation.pdf.

[6] Revision of Certain Exemptions from Registration for Transactions Involving Limited Offers and Sales, Securities Act Release No. 6389 (March 8, 1982), 1982 WL 35662.

[7] Final Rule: Amending the Accredited Investor Definition Notice, 17 C.F.R. §230, 240 (Aug. 26, 2020), https://www.sec.gov/rules/final/2020/33-10824.pdf ("The final rules are tailored to permit investors with reliable alternative indicators of financial sophistication to participate in such investment opportunities, while maintaining safeguards necessary for investor protection and public confidence").

[8] 17 C.F.R. § 230,501(a).

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

[10] Gina-Gail S. Fletcher, Comment Letter on Assembly Bill 75, 2023 Leg., 82nd Sess. (Nev. 2023), available at https://drive.google.com/file/d/12c5i4Jfd_kPB2PHhVykMly0mEMzvEAAe/view.

The SEC's Investor Advisory Committee issued a recommendation for setting an appropriate dividing line for access to private markets. After carefully considering the issue, it found that an effective exemption standard should identify investors who are: (1) sufficiently sophisticated based on their knowledge and experience; (2) able to obtain or negotiate for access to important financial information; and (3) able to bear the economic risks associated with the private offering.[11] AB75's "Nevada certified investor" definition accomplishes none of these goals.

Like the federal accredited investor standard, AB75 improperly relies on financial metrics as a proxy for sophistication. In reality, private market investing often requires a high level of financial knowledge and expertise. In 2021, the median education level attained by Nevadans was that of "some college experience."[12] Without so much as an associate degree, individuals almost certainly be unable to accurately evaluate the validity and risks associated with private offerings. An effective metric should build upon the federal standard by imposing a minimum investment threshold, requiring professional credentials or relevant financial knowledge examination.[13] Instead, the proposed bill attempts to weaken standards even further to the detriment of Nevadans.

Nothing about the proposed class of Nevada certified investors suggests they will be able to negotiate for important financial information. AB75 imposes no disclosure obligations, meaning any disclosure will be voluntary. Functionally, Nevadans will depend on representations made by the issuer, which may contain overly optimistic (if not outright fraudulent) assumptions regarding future prospects.

Lastly, AB75's expansive intrastate exemption lowers the financial thresholds to the point that it exposes individuals who cannot afford to lose their investments. A Nevada certified investor, with half the income of a federal accredited investor, stands to lose just as much of their life savings in ill-advised investments.

III. AB75 Fails to Provide Adequate Protection to Nevadans Participating in Private Market Offerings.

AB75's income threshold assumes Nevadans earning at least $100,000 per year can protect their own interests in private markets. In reality, individual investors, regardless of income, may be taken advantage of in numerous ways that AB75 fails to address. We discuss these disadvantages as well as our specific concerns with AB75's shortcomings below.

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[11] Investment Advisory Committee, SEC, Accredited Investor Definition (October 9, 2014), https://www.sec.gov/spotlight/investor-advisory-committee-2012/investment-advisor-accredited-definition.pdf.

[12] U.S. Census Bureau, AMERICAN COMMUNITY SURVEY: 2021 ACS 1-YEAR ESTIMATES (2021), https://data.census.gov/table?q=education+in+Nevada+in+2021&tid=ACSST1Y2021.S1501.

[13] SEC Staff Report, Report on the Review of the Definition of "Accredited Investor" (Dec. 18, 2015) https://www.sec.gov/files/review-definition-of-accredited-investor-12-18-2015.pdf. The SEC staff recommended that the Commission consider permitting individuals to invest if they meet minimum investment thresholds, have professional credentials, have certain investment experience, are knowledgeable employees of private funds or pass an examination.

a. Adverse Selection

The lack of disclosure requirements and the information asymmetry involved in exempt private market securities offerings can lead to significant adverse selection problems for Nevada investors. Consider the capital formation landscape a promising business venture would face if AB75 passed. It could either raise capital from a small group of relatively sophisticated investors able to contribute larger sums under the existing rules and or it could pursue a mass of Nevadans making over $100,000 a year. Persuading a larger group to invest will consume more time and resources. Assuming the venture is not a fraud, communicating and coordinating with the larger group about their investment afterward will also take up more time than talking to a smaller group.

Promising businesses able to raise capital under the existing rules will likely continue to use the existing rules. To the extent AB75 would allow more businesses to raise capital, it would likely expand access to capital for the least promising and most ill-advised ventures currently unable to access capital. Put another way, this amendment makes it easier for new businesses to raise money who would otherwise not be able to, but not for good reasons. Businesses which are not considered creditworthy or investment worthy, and therefore unable to raise needed funds from banks and other sophisticated financial services institutions, will instead turn to these individual investors who bear lower degrees of sophistication and are therefore more likely to be drawn in by unrealistic representations of potential returns.

Moreover, the negotiating leverage for large investments differs from the leverage available for small investments. Even in a private market negotiation, a venture capital firm has bargaining power to obtain information and the resources to conduct some due diligence. In contrast, the individuals who will be fleeced under AB75 will not have the bargaining power to obtain truthful information or the resources to conduct any meaningful due diligence. As a result, the people who will suffer the losses when inevitably some, if not many or most, of these small capital raises fail, will be small individual investors least able to afford the loss.

b. Illiquidity Problems

Liquidity is another issue associated with private offerings. If investors buy offerings under AB75, no market will exist for them to sell the securities. Even if the investor located some interested potential buyer, the subsequent purchaser must incur additional costs of conducting their own due diligence to determine a fair price. This price will likely be at a steep discount to value because, again, no market for these securities will exist.

Ordinary investors often run into problems which cause them to need to sell investments. All too often, unexpected medical debts or job loss create unforeseen liquidity needs. Without any market for these securities, the investors will have no practical or timely ability to sell them. Moreover, these investments can be illiquid for an indeterminable amount of time. Investors are frequently induced to invest in non-publicly traded investments with claims that they will get their money back within a relatively short period of time, maybe 5-7 years. What investors often don't realize is that those projections are non-enforceable guesses, and they may have to hold that investment for a decade or longer to get their money back, if they ever do.

Another meaningful problem is that the lower-income Nevadans most ready source of investment funds is their retirement funds. Using 401K rollovers or IRAs to purchase illiquid private placements puts those investors at risk should they find themselves of an age whereby they must take required minimum distributions per IRS rules. Obviously, those RMDs cannot be sourced from illiquid holdings.

c. AB75's Limitations Provide No Protection

AB75's limitation of the investment amount to 10% of the Nevada certified investor's net worth per transaction creates a serious loophole for private issuers to exploit. This per-transaction limitation does not prevent issuers from taking more and more from investors with subsequent transactions. Rather, when combined with the proposed amendment, it incentivizes issuers to repeatedly target the same investors, gradually draining them of their financial resources. Once an issuer has 75 certified investors, it may only raise additional funds from the same pool of investors. These issuers will likely pressure existing investors with rosy projections and broadcast the business' "growth" even if it's simply burning through investor capital. As the business will lack independent valuation, issuers can simply spin positive stories to separate investors from their cash. With a perceived increase in net worth, the investor may be persuaded to give more of their capital to the issuer. Ultimately, the 10% limitation is effectively meaningless; it does nothing to limit the investor's potentially grossly over concentrated investment in incredibly high risk endeavors, only slow it down slightly.

Issuers may alternatively bypass the amendment by selling a portion of equity into a separate entity, thus allowing the controllers of the new entity to draw funds from new investors. Without proper safeguards or financial disclosures to detect such behavior, this restriction is also ineffective.

d. Retirement and Primary Residence Assets Should be Excluded

AB75's inclusion of primary residence and retirement savings in net worth calculations further compounds the issues mentioned above. Excluding these assets from the calculation of net worth is not only necessary for protecting vulnerable investors, but it is also a practical consideration. If an individual were to invest using their primary residence, they would likely need to take out a loan against it to access the liquidity needed to invest. This would increase their level of exposure to the investment, as they would be risking not only their investment but also their home. Excluding these assets is a common-sense approach to protecting investors from undue risk and ensuring that they can continue to rely on their primary residence and retirement savings for future stability.

e. Financial Intermediary Disclosure

Many businesses work with brokerage firms to raise capital. Businesses often agree to pay a commission whenever the brokerage firm recommends the business' securities to its customers. However, investors may not understand how this conflicted incentive structure drives the broker-dealer's recommendation. Brandon Dei, one of PIABA's member attorneys, described his experiences representing clients harmed in private placement offerings in the following statement:

> The most significant issue that I have seen when dealing with clients who lost an investment with a private placement offering is that the client has no knowledge that: 1) these private placement offerings are entirely commissioned incentive for the broker-dealer firm in the sale of the stock - not in the future performance of the stock; and 2) broker-dealers will usually do several offerings of the same company a few years in a row, thereby diluting the shares, decreasing the share price, and hurting their own client-investors. If the state of Nevada will allow for non-accredited investors to make investments in these offerings, the broker-dealers should also disclose all of their private placement offering deals to show a track record of how many of these companies actually succeed - most fail miserably for the investors.

Dave Liebrader, another PIABA member and a practicing Nevada securities attorney echoed Mr. Dei's concerns, adding:

> As a Nevada lawyer who regularly represents investors, I am concerned about the legislation including a person's house when calculating their net worth for this sort of exemption. It creates a real risk that Nevadans will end up losing their homes. The proposed exemption also lacks basic protections such as conflicts disclosures or a requirement for any financial history. Having seen too many people hurt under the existing private offering rules, I hope the Nevada legislature does not make this mistake.

f. Frauds Abound in Private Markets

Fraud runs rampant in private markets. State regulators repeatedly point out unregistered offerings as a main source of securities fraud.[14] While not immune from fraudulent schemes, public market transactions are much less likely to be frauds. Recent events involving digital assets - including the FTX scandal- showcase the potential for harm when markets are allowed to operate outside of the parameters of securities laws.[15]

Consider for example, the recent Ponzi scheme that targeted members of the Mormon Church community for five years.[16] The perpetrators, including a Nevada attorney, operated under the guise of a risk-free investment opportunity involving advanced payments to tort victims.[17] Over 600 hundred individuals parted with roughly $449 million based on the promises of guaranteed returns. In reality, their money was used to finance the perpetrators' luxurious lifestyles and pay fictitious returns to keep the investment going.[18]

Affinity frauds such as this allow bad actors to exploit shared affiliations and conjure a false sense of trust. Those operating by selling unregistered securities have no obligations to

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[14] NASAA Report at 26.
[15] Gina-Gail S. Fletcher, Comment Letter on Assembly Bill 75, 2023 Leg., 82nd Sess. (Nev. 2023).
[16] Complaint at 1*, SEC v Beasley*, F.Supp. 2d (D.Nev. 2022).
[17] *Id.* at 2.
[18] *Id.* at 1-2.

substantiate the claims made to unsuspecting individuals. An intrastate exemption with lowered thresholds will only give these bad actors further opportunities to take advantage of a larger pool of unsuspecting investors.

g. AB75's Proposed Background Check Lacks Structure

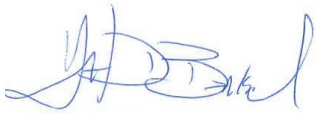
Moreover, the proposed amendment's safeguards would do nothing to prevent such fraudulent schemes as they are not properly tailored to the securities markets. The amendment requires issuers to undergo a background check similar to that used for education licenses issued under N.R.S. 391.033. In private markets, however, the issuer is usually an entity seeking exemption. The statute has no process -unsurprisingly- for investigation into such entities, nor does it identify which executives, officers, and directors are subject to individual background checks. Further, the amendment offers no roadmap for regulators to rely upon should the background check reveal any problematic behavior. If, for instance, an executive of the issuing company has a criminal record, is the company automatically disqualified from the exemption? Is the issuer able to cure any deficiencies by terminating the executive's employment? Can the issuer rebut any substantiated reports revealed during the background check? While this requirement has the potential to benefit investors, in its current form, it falls significantly short of what is needed.

IV. Conclusion

Once again, PIABA appreciates the opportunity to comment on AB75. We urge the Nevada legislature to reject this bill that exposes far too many Nevadans to substantial financial harm.

PIABA would be happy to engage with the Nevada legislature further on this matter.

Respectfully submitted,



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