



PUBLIC INVESTORS ADVOCATE BAR ASSOCIATION

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March 2, 2023

Via Electronic Submission:

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The Honorable Wyman Duggan, Chair
Insurance & Banking Subcommittee
303 House Office Building
402 South Monroe Street
Tallahassee, FL 32399-1300

The Honorable Christine Hunschofsky, Ranking Member
Insurance & Banking Subcommittee
329 The Capitol
402 South Monroe Street
Tallahassee, FL 32399-1300

**Re: OFR Bill Reforming Chapter 517 - Recommendation to Support
Florida's Office of Financial Regulation Ch. 517 Reform
Legislation**

Dear Chair Duggan and Ranking Member Hunschofsky:

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 such 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 rules promulgated by the Florida Office of Financial Regulations (the “OFR”) relating to exempt offerings, the practices of brokers and broker-dealers, and investor protection.

I. Introduction

PIABA is concerned with the current effort to pass deregulatory legislation that would dramatically expand the ability of unlicensed individuals, so-called “finders,” to solicit and engage

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in securities activities **on behalf of private issuers and receive transaction-based compensation without being subject to appropriate regulatory oversight.** We are especially concerned that efforts to expand crowdfunding offerings to retail investors in an exempt offering could result in harm to accredited elderly investors, who are unsophisticated and may face challenges in analyzing and valuing such securities or who may be confused by the descriptions of such securities on the funding portals. The OFR’s proposed expansion of crowdfunding offerings under the auspices of facilitating capital formation is an abrogation of the OFR’s core mission to protect Florida investors, and maintain safe, fair, orderly, and efficient markets.”¹

As you may know, PIABA opposed deregulatory proposals Fla. H.R. 779 and Fla. S. 1536 (“2021-2022 Proposed Legislation”)² that are the same or similar to the ones set forth under Fla. H.R. 253 and Fla. S. 180 (“2023 Proposed Legislation”). Much like the 2021-2022 Proposed Legislation that died in House of Representative’s Insurance & Banking Subcommittee in March 2022, we believe the 2023 Proposed Legislation demonstrates a radical, negative policy change in light of its proposed expansion of private issuer’s ability to market their securities to financially unsophisticated retail investors. These investors, many of whom are elderly and vulnerable, are ill-prepared to protect themselves from unscrupulous individuals who engage in deceptive and abusive solicitation activities. In short, the OFR is sacrificing investor protection by failing to give any serious consideration to how these investors would be affected by its radical deregulatory proposal in favor of capital formation and special interest hand-outs.

The 2023 Proposed Legislation should be narrowly tailored to address the capital formation needs of entrepreneurs and certain smaller issuers while preserving investor protections. Expanding exempt offerings in the manner proposed will do nothing to promote capital formation in the public markets and will ultimately have negative consequences for investors. Additionally, the 2023 Proposed Legislation expands the pool of investors who may be eligible to invest in exempt offerings. The 2023 Proposed Legislation is solely focused on expanding the private markets that would unquestionably cause retail investors harm. The OFR does not even acknowledge that finders are often associated with fraudulent activity and the Proposed Legislation does not ensure that finders are subject to appropriate regulatory oversight. The most likely outcome of the 2023 Proposed Legislation will be to increase private issuers, which will have the harmful effect of depriving investors in those companies of the benefits of registration.

II. Expansion of Exempt Offerings Will Undermine Investor Protection

Expansion of exempt offerings to Florida retail investors will almost certainly increase the risks to which retail investors are exposed to while decreasing the information available to investors attempting to perform due diligence. It will also substantially increase the number of instances in which Florida investors fall prey to fraudulent investment schemes. These implications

¹ See The Florida Office of Financial Regulation, Our Mission, available at <https://flofr.gov/sitePages/AboutOFR.htm>.

² See Letter from PIABA President Michael Edmiston to Michelle Suarez and Ton Tsvetanova, Re: OFR Bill Reforming Chapter 517 (Jan. 3, 2022), available at <https://piaba.org/piaba-newsroom/comment-letter-ofr-bill-reforming-chapter-517-recommendation-support-floridas-0>.

are significant and must be addressed if the OFR is to honor its mission of protecting the investing public. If the OFR is to expand the pool of investors who may be eligible to invest in exempt offerings, it must simultaneously improve investor protections for those who are eligible to invest.

The evidence is clear that fraud and other harms occur frequently where unregistered persons promote unregistered products to retail investors. In August 2020, the SEC's Division of Economic and Risk Analysis ("DERA") published a study of fraud in the private markets based on SEC enforcement actions brought over a single year.³ Results from the DERA' study showed the majority of offerings were fraudulent offerings that did not qualify for an exemption from registration.⁴ DERA's study further found that "offerings linked to SEC enforcement actions more likely involved an unregistered intermediary or a recidivist, or solicited from unsophisticated investors."⁵ Importantly, the DERA study found that while Florida had the sixth largest number of Regulation D issuers compared to other states, it had the highest number of issuers with unregistered offerings.⁶ Florida also has the highest proportion of seniors in its population and accounts for the second largest number of seniors amongst all states.⁷ With more than half of financial assets in the U.S. estimated to be owned by seniors,⁸ elderly investors are considered to be the most targeted and vulnerable to financial exploitation.⁹

III. Finder's Exemption

PIABA opposes the proposed registration of finders ("Finder's Exemption") for many of the same reasons PIABA opposed the U.S. Securities and Exchange Commission (the "SEC") Release Number 34-90112, Notice of Proposed Exemptive Order Granting Conditional Exemption from the Broker Registration Requirements of Section 15(a) of the Securities Exchange Act of 1934 for Certain Activities of Finders (the "Proposed Finders Exemption").¹⁰ We strongly believe that if a finder acts as a broker with respect to the securities activities of non-reporting issuers, they should be subject to all of the requirements that would apply to a broker-dealer when acting in that same capacity.

In December 2021, after receiving numerous comments expressing significant concerns that the exemption could undermine investor protection, the SEC announced that it would not move forward with the proposed exemption.¹¹ While the exemption was intended to help small businesses and startups raise capital, the SEC determined that the Proposed Finders Exemption

³ Rachita Gullapalli, *Misconduct and Fraud in Unregistered Offerings: An Empirical Analysis of Select SEC Enforcement Actions*, SEC Division of Economic and Risk Analysis (Aug. 2020) ("DERA Study"), available at <https://www.sec.gov/files/Misconduct%20And%20Fraud%20In%20Unregistered%20Offerings.pdf>.

⁴ *Id.* at 33.

⁵ *Id.* at 11.

⁶ *Id.* at 19.

⁷ *Id.*

⁸ *Id.*

⁹ *Id.*

¹⁰ See Letter from PIABA President David P. Meyer to Vanessa Countryman, Re: File No. S7-13-20 (Nov. 12, 2020): available at <https://www.sec.gov/comments/s7-13-20/s71320-8011738-225383.pdf>.

¹¹ See Annual Report for Fiscal Year 2021, Office of the Advocate for Small Business Capital Formation ("OASB") at 64, available at <https://www.sec.gov/files/2021-OASB-Annual-Report.pdf>

was not in the best interests of investors or the integrity of the securities markets. Since then, the SEC has not taken further action on the proposal, and the provision of regulatory clarity for finders is not in the Commission's current regulatory agenda.¹²

In the 2023 Proposed Legislation, similar to the Proposed Finders Exemption, finders would not have to possess any minimum knowledge or competency with respect to securities to qualify for the exemption, nor would they have to pass any examinations or undergo any training or continuing education to serve as a finder. Because the exemption would allow virtually any individual to promote sales of unregistered securities so long as the individual was not statutorily disqualified, there would be no assurance to the investor, the issuer, or the securities market at large that such individuals have the knowledge, skills, integrity, or competency to serve investors or issuers in capital raising activities.

Under the federal securities laws, finders would not need to notify regulatory authorities of their activities, or to keep any records of their activities, communications, or finances, making it extremely difficult for the Commission or any other regulator with jurisdiction over finders to determine whether they were complying with the exemptive order or other applicable laws and standards. There would be no database, such as BrokerCheck, for investors to learn more about a finder's background, including any customer complaints or past crimes or disciplinary actions that do not trigger disqualification.

The 2023 Proposed Legislation would not allow finders to participate in the preparation of issuer sales materials, but in our experience, persons involved in securities sales are typically involved in the preparation of the sales materials used to promote an offering. Moreover, it is not clear from the 2023 Proposed Legislation whether a finder may provide investors with projections of the price performance of a privately offered security, which generally is not permissible for broker dealers.

Because there would be no regular oversight of the use of these materials or standards applicable to such sales materials other than general anti-fraud laws, there remains a risk that Finders may be involved in preparing sales materials that are designed to maximize sales at the cost of compliance with standards requiring such communications to be fair and balanced.

Further, because finders would not need to have any background in the securities industry or pass minimum knowledge or competency examinations, it is possible they would not even recognize when they are providing misleading content to investors. The North American Securities Administrators Association ("NASAA") issues enforcement reports every year that summarize enforcement actions filed by state regulators. NASAA's recent Enforcement Report show that

¹² See Office of Information and Regulatory Affairs, Office of Management and Budget, U.S. Securities and Exchange Commission Agency Rule List (Fall 2022) available at https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST¤tPub=true&agencyCode=&showStage=active&agencyCd=3235&csrf_token=7CE97CC2D49C9B6B70868F7B2752E582C86F1945A4A46F34426C18AF1ABE101E611318F64B67159C3A36E7556BD0FB872C8F.

during 2019, state securities regulators brought 738 enforcement actions against unregistered persons, including 57 unregistered finders or solicitors.¹³

In addition, finders should be required to do their own due diligence before making a recommendation. Prohibiting finders from investigating or performing reasonable diligence on an issuer or its securities could provide a shield from liability for a finder in an investor's claim that he/she suffered losses from the finder's solicitation activities. For example, a finder would likely assert that the restriction from performing due diligence on the issuer, and thus any claims by an investor that the finder should have known about any fraud or investment risk related to the investment, would run counter to the finder's obligations.

Additionally, if the OFR does move forward with the finder exemption, it should be limited only to natural persons because permitting entities to come into this space opens the door to boiler room operations and other fraudulent enterprises acting under the approval of an OFR exemption, which increases the potential harm to investors significantly.

IV. Crowdfunding

The Task Force's reasoning to expand crowdfunding offerings is deeply flawed. As support for the proposed reform measures, the OFR states that "to date there has not been a single securities offering under Florida's crowdfunding statute."¹⁴ As further support, the OFR states that "there have been numerous offerings in Georgia under their crowdfunding provisions that are substantially similar to the OFR's reform proposals."¹⁵ Despite the Task Force's assertions, not only has Florida had numerous crowdfunding offerings under its existing regulatory framework but in 2022 Florida had 115 offerings; ranking it among the top three states, after California and New York.¹⁶ Moreover, in 2022 Georgia had 42 offerings or 64% less crowdfunding offerings than Florida.¹⁷ Thus, mirroring Georgia's crowdfunding provisions will not likely increase capital raising opportunities for smaller companies.

PIABA is adamantly opposed to the growth of unregulated crowdfunded offerings. Our members have found that unsophisticated retail investors are the ones most likely to fall victims to fraudulent unregulated crowdfunding offerings. In 2020, crowdfunding offerings in the U.S. raised \$239 million.¹⁸ Two years later, crowdfunding offerings soared to \$494 million, raising more than twice the amount raised in 2020.¹⁹ The OFR should not increase or waive the current annual cap on investors, accredited or not. More control and review will protect investor. Increasing offering

¹³ See NASAA 2020 Enforcement Report at 5, available at <https://www.nasaa.org/wp-content/uploads/2020/09/2020-Enforcement-Report-Based-on-2019-Data-FINAL.pdf>.

¹⁴ See Ch. 517 Task Force Report at p. 3.

¹⁵ *Id.*

¹⁶ See Annual Report for Fiscal Year 2022, OASB at 16, available at <https://www.sec.gov/files/2022-oasb-annual-report.pdf>.

¹⁷ *Id.*

¹⁸ See Alois, JD, *\$239 Million was Raised using Reg CF During 2020, this Amount Could Double in 2021*, Crowdfund Insider (Jan. 6, 2021), available at <https://www.crowdfundinsider.com/2021/01/170982-239-million-was-raised-using-reg-cf-during-2020-amount-could-double-in-2021/> (citing a report by Crowdfund Capital Advisors ("CCA")).

¹⁹ See Brian, *2022 Equity Crowdfunding Stats and Top Platforms* (Jan. 16, 2023), available at <https://crowdwise.org/funding-portals/2022-equity-crowdfunding-stats-and-top-platforms/>.

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document disclosure and auditing, as well as regulating or limiting promotion and advertising are all worthwhile provisions which should be adopted.

Additionally, the Task Force proposes to create a new exemption for micro-offerings under \$50,000. While a micro-offering could allow small business access to investors' capital, businesses seeking relatively small amounts of capital should use traditional forms of financing, like commercial loans. The risk inherent in micro-offerings is not the type of risk that should be passed on to investors. Further, the ability of a business to issue a new micro-offering every thirty days would create a loophole for fraudsters to exploit, allowing them to raise larger amounts of capital than should be allowed under a micro-offering exemption by utilizing serial micro-offerings across a short period of time.

Finally, please note that PIABA members commonly see cases where the investor is unaware of the liquidity or illiquidity of an investment which they are holding. In 2019, the SEC published the results of a study conducted by its staff on the capital formation and investor protection impacts of Regulation Crowdfunding (the "SEC Crowdfunding Report").¹⁴ According to the SEC Crowdfunding Report, the average issuer had "no revenues (just over half of the offerings were by issuers with no revenues)."¹⁵

V. Conclusion

Once again, PIABA appreciates the opportunity to comment on the OFR's 2023 Proposed Legislation. We urge the OFR to remember its mission to protect investors while it tackles the legitimate goal of simplifying the exempt offering framework. Although increasing the efficiency of the capital markets and ability of companies to raise money is a laudable goal, it cannot be done to the detriment of Florida investors.

PIABA would be happy to engage with the OFR further on this issue.

Respectfully submitted,

A handwritten signature in blue ink, appearing to read "H. Berkson".

Hugh D. Berkson, President
Public Investors Advocate Bar Association