**PUBLIC INVESTORS ADVOCATE BAR ASSOCIATION**
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November 12, 2020

Via Email: rule-comments@sec.gov
Ms. Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: SEC File Number S7-13-20 - 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

Dear Ms. Countryman:

I write on behalf of the Public Investors Advocate Bar Association ("PIABA"), an international, not-for profit 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 U.S. Securities and Exchange Commission ("SEC") that govern the practices of brokers and broker-dealers.

PIABA strongly opposes SEC File Number S7-13-20 ("Proposed Exemptive Order"), which seeks to dramatically expand the ability of unregistered – and hence unsupervised – individuals, so-called "Finders," to engage in certain brokerage activities on behalf of private issuers, and to be compensated through transaction-based payments, without being subject to the regulations designed to protect investors from unscrupulous sales activities. For the reasons detailed below, PIABA believes that a Finder must be subject to all of the requirements that would apply to a broker-dealer when acting in that same capacity.

The Proposed Exemptive Order frustrates the SEC's mission to protect investors, contradicts significant SEC precedent regarding broker-dealer registration, and is contrary to the SEC's warnings that allowing Finders to receive transaction-based compensation would incentivize abusive sales practices that registration/licensure is intended to regulate and prevent. Moreover, even assuming that the terms of the Proposed Exemptive Order may "clarify" the regulatory status of Finders and/or benefit small and minority-owned businesses' ability to raise capital, acting through an exemptive order is not the proper means to achieve those ends. This proposal should be withdrawn.

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## I. The Devastating Impact to Investor Protection

The Proposed Exemptive Order seeks to establish two "tiers" of Finders and, among other deleterious provisions, permits the following:

- All Finders may receive transaction-based compensation, incentivizing aggressive sales tactics at the expense of investors;
- Tier I Finders are not required to provide investors with written disclosures, thereby undermining the SEC's stated goal of transparency for investors;
- Tier I Finders may only participate in one (1) capital raising transaction in a 12-month period, which will encourage them to engage in aggressive sales tactics at the expense of investors;
- While there are some limitations for Tier II Finders, they essentially can do what a broker does to solicit accredited investors for non-registered, private company investments, thus wholly undermining the purpose of regulation and licensure of brokers; and,
- There are no limits on the amounts that can be raised from investors, the size of the offerings, or the types of issuers that can take advantage of the relief. Instead, issuers of any size would be permitted to employ Finders to raise unlimited amounts of capital without regulatory oversight.

Under the terms of the Proposed Exemptive Order, a Tier II Finder would be permitted to engage in a wide range of activities that the SEC has long held constitute brokerage activities that should be regulated and subject to appropriate oversight. For example, the Proposed Exemptive Order would permit unregistered Finders to contact potential investors, distribute sales material, discuss the sales material with investors, participate in meetings with the issuer and investors, and receive transaction-based compensation. All of these activities would be permitted without any regulatory oversight, even though brokers engaging in the same activities are subject to oversight, conduct rules, and discipline should the broker engage in misconduct while undertaking these same activities. Finders can and will engage in misconduct that the industry's regulatory rules are designed to prevent, namely soliciting unaccredited investors, misrepresentations and omissions, and other broker bad acts, knowing their activities are less likely to be noticed by regulators.

The SEC is well aware that private markets, as compared to public markets, are less liquid, impose higher transaction costs, are susceptible to valuation errors, often provide opaque or *de minimus* financial information, and are highly prone to fraud.[1] Finders in particular are often associated with fraudulent activity.[2] Regulators historically

[1] *See* NASAA, Comment Letter on Proposed Rule to amend the "Accredited Investor" definition (Mar. 16, 2020) ("private offerings are often characterized by opaque disclosures, related party transactions, illiquidity, minimal financial information and, unfortunately, fraud."). *See also* NASAA, Legislative Agenda for the 116th Congress (Mar. 5, 2019) ("NASAA Report") at n. 10 ("There is a well-documented relationship between private offerings sold by brokers and an elevated risk of fraud, and a disproportionate percentage of persons acting as brokers in the private offering marketplace are brokers with red flags in their record.") (citing Jean Eaglesham and Coulter Jones, A Private Market Deal Gone Bad: Sketchy Brokers, Bilked Seniors and a Cosmetologist, The Wall Street J. (May 7, 2018)); PIABA, Comment Letter on Concept Release: Harmonization of Securities Offering Exemptions (Sept. 24, 2019) (listing SEC enforcement actions in connection with private securities offerings).

[2] *See* Advisory Committee on Small and Emerging Business, Notable by Their Absence: Finders and Other Financial Intermediaries in Small Business Capital Formation, (Jun. 3, 2015) (stating that, in many cases, "persons acting as finders represent 'the dark side' of the securities business: purveyors of fraudulent shell corporations; front-end fee con artists; purported Regulation S specialists who send stock off-shore and wait to dump it back into the U.S. through unscrupulous brokerage firms or representatives who are receiving under-the-table payments for promoting stocks and micro-cap manipulators.").

have waged war on unregistered Finders because their actions undermine the investor protection measures in every security law.

> Regulators have a substantial concern over the "finders" who flout the securities laws. We estimate that the various states bring well over 100 enforcement cases against unregistered finders on an annual basis (and probably a great deal more because statistics are not available from NASAA or the states to identify the full extent of state action). The NASD brings a large number of cases against individuals who are engaged in selling away from their brokerage firms for acting as unregistered financial intermediaries, often barring them from the business or imposing long suspensions. This is the second most frequently cited grounds for sanctioning registered representatives and has been for the past several years.[3]

Since both Tiers receive transaction-based compensation, Finders have an incentive to aggressively pursue investors by any means necessary, and financial professionals often push these products to unsophisticated investors. PIABA's members frequently see private securities presented as alternative income investments appealing to elderly investors often living on a fixed income. The products are pitched as offering income higher than what is available in conventional fixed-income securities, and/or also providing diversification to the investor's portfolio because their value is not correlated to the stock market or other conventional asset classes. Many clients solicited to invest in these types of products end up losing their entire investment.

The only investor protection the SEC has proposed is in the form of disclosure, and only for Tier II Finders. The SEC will require the Tier II Finders to provide a potential investor the following disclosure:

- the name of the Tier II Finder;
- the name of the issuer;
- the description of the relationship between the Tier II Finder and the issuer;
- a statement that the Tier II Finder will be compensated for their solicitation activities by the issuer and a description of the terms of the compensation arrangement;
- any material conflicts of interest resulting from the relationship between the Tier II Finder and the issuer; and
- a statement that the Tier II Finder is acting as an agent of the issuer, is not a an associated person of a broker-dealer, and is not undertaking to act in the best interests of the investor.

Surprisingly, these disclosures may be made orally by the Finder, although the investor must also receive a written disclosure no later than the time of the investment. This in no way adequately replaces the standards of conduct that a registered broker-dealer would be subject to when soliciting a prospective investor. First, it will be virtually impossible for the SEC to police the oral disclosures to ensure that they are adequate. Second, the written disclosures will come too late, and will likely be consumed by the myriad other disclosures an investor receives at the time of an investment. Third, the SEC has ample evidence that disclosure is not effective investor protection.

With respect to private placements, PIABA members often see broker-dealers placing blank subscription agreements or subscription agreements rife with incorrect information before investors and convincing them to sign them. The investors do not read the documents; they do not examine the statements they are certifying in the documents; they rely on the statements made by their trusted advisor and sign where they are told to sign. The brokers then rely on those documents to disclaim liability. The only party protected by the disclosures are the brokers.

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[3] American Bar Association, Report and Recommendation of the Task Force on private Placement Broker-Dealers at 13 (June 20, 2005).

Moreover, the SEC relies on the fact that Finders will be limited in working with proposed investors who are accredited investors or who the Finders reasonably believe are accredited investors. This also offers little comfort in terms of investor protection. Last month, the SEC declined to update the accredited investor definition to account for inflation that has occurred since the income and net worth standards were first adopted in 1982.[4] At that time, only about 1.5 million households, 1.8%, qualified as accredited investors.[5] Today, 16 million, or 13% of households qualify as accredited investors.[6] Investors who, merely by the effects of inflation, qualify as accredited often do not have a "sufficient level of financial sophistication to participate in investment opportunities that do not have the additional protections provided by registration."

The standards of conduct governing broker-dealers recognize that simply meeting income and net worth standards does not make an investor "sophisticated" or make a private placement an appropriate investment for an accredited investor. Broker-dealers must still adhere to either the FINRA suitability rule or Regulation Best Interest to ensure that such an investment is appropriate for such an investor. Under the Proposal, all accredited investors will lose those protections when a Finder presents the offering.

The SEC's proposal to eliminate the important investor protections the established broker-dealer framework provides in an area of the securities markets that is already prone to fraud is misguided. Our members have seen firsthand what unregistered Finders can do to investors, and we received thousands of calls from investors who were scammed by these people during the recent $1.2 billion Ponzi scheme known as the Woodbridge Group of Companies ("Woodbridge"). Robert Shapiro was able to unleash his Woodbridge investment fraud scam in every corner of the country by using an enormous team of unregistered Finders.

Unregistered Finders widely marketed Woodbridge as safe and secure and a conservative retirement and income plan, and thousands of unsophisticated retirees unknowingly bought into the sales pitch from these individuals. The SEC cracked down on the Woodbridge unregistered Finders by filing multiple fraud lawsuits, stating that "[t]he broker-dealer and securities registration provisions are vital protections for retail investors... the defendants, while not registered as broker-dealers, pocketed millions of dollars in unlawful commissions from their widespread sales of unregistered Woodbridge securities." SEC Press Release 2018-157, *SEC Charges Unregistered Brokers Who Sold Woodbridge Securities to Main Street Investors* (August 20, 2018). It is unclear how the SEC can recognize the abuse investors suffer at the hands of unregistered Finders, and the importance of registration provisions in protecting investors, yet support the Proposed Exemptive Order, which will almost certainly result in further abuses akin to the Woodbridge debacle.

## II. The Intended Beneficiaries – Small and Minority-Owned Business – May Also Be Adversely Impacted by Allowing Unregulated Finders to Engage in Broker Activities

Investors are not the only ones put at risk by allowing unregistered Finders to engage in broker activities. Private issuers who deal with unscrupulous Finders may never see any of the monies purportedly raised by their offering. Even when the businesses do receive funding, dealing with unscrupulous Finders can present significant problems for the issuer. "They can taint an offering by creating the basis for rescission rights, raise enforcement

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[4] *See* SEC, Accredited Investor Definition, 85 Fed. Reg. 64,234 (Oct. 9, 2020).

[5] *See* SEC, Report on the Review of the Definition of "Accredited Investor" (Dec. 18, 2015).

[6] *See* SEC, Concept Release on Harmonization of Securities Offering Exemptions, 84 Fed. Reg. 30,460 (June 26, 2019).

concerns, make fraudulent representations and engage in general solicitation which disqualifies the offering for exemption from registration."[7]

While these issues are clearly significant, the Proposed Exemptive Order fails to acknowledge that fraudulent activity by Finders is a widespread problem it should seek to address. That is an abrogation of the SEC's central investor protection mission and its capital formation mandate. Because, unless the Commission also deals with the fraud problem, simply clarifying the regulatory status of Finders is unlikely to promote healthy capital formation.

## III. Finders Get All of the Benefits, None of the Restrictions

The Proposed Exemptive Order proposes to allow Finders to engage in conduct that the SEC has long held constitutes brokerage activity that should be regulating in order to protect investors from unscrupulous bad actors. The only supposed limitation is that a Finder may not provide advice as to the valuation or advisability of the investment. Commissioner Lee provides a clear picture of what this looks like in practice:

Imagine a discussion in which a finder, who stands to gain proportionately for every dollar invested, finds an investor, teams up with an issuer to present offering materials and analysis, and sings the praises of a proposed investment. All she needs to do to avoid registration is refrain from concluding the presentation with the words "you should invest." The issuer itself can handle that last step, if it is even needed.[8]

Commissioner Lee is correct: the supposed restriction is only a restriction in form, not substance. There is no practical difference between allowing a Finder to state, "Boy, do I have a wonderful investment for you," but not allowing them to say, "you should invest." In both instances, the sale of a security has been solicited. In fact, the securities industry concluded long ago that the scope of the proposed activities for Finders would in fact be a "recommendation" that should trigger the requirements of FINRA and SEC rules governing recommendations, including Regulation Best Interest. Now, three months after the compliance date for Regulation Best Interest, the SEC proposes rolling back those protections, as well as other crucial protections, in favor of allowing security sales with no obligation to comply with industry rules.

## IV. The SEC Has Consistently Viewed Transaction-Based Compensation as the Hallmark of Broker-Dealer Activity

A person's receipt of transaction-based compensation is a hallmark of broker-dealer activity.[9] Accordingly, any person receiving transaction-based compensation in connection with another person's purchase or sale of securities typically must register as a broker-dealer or be an associated person of a registered broker-dealer.

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[7] *Id.*

[8] Commissioner Allison Herren Lee Public Statement, *Regulating in the Dark: What We Don't Know About Finders Can Hurt Us* (October 7, 2020).

[9] *See* Securities Exchange Act Release No. 61884 (April 9, 2010) ("the receipt of transaction-based compensation often indicates that such a person is engaged in the business of effecting transactions in securities." (internal citation omitted)). *See also* Letter from Catherine McGuire, Chief Counsel, Division of Market Regulation, to Thomas D. Giachetti, Stark & Stark, regarding 1st Global, Inc. (May 7, 2001) (reiterating the staff's position that "the receipt of securities commissions or other transaction related [*sic*] compensation is a key factor in determining whether a person or an entity is acting as a broker-dealer. Absent an exemption, an entity that receives commissions or other transaction-related compensation in connection with securities-based activities that fall within the definition of 'broker' or 'dealer' ... generally is required to register as a broker-dealer." (internal citations omitted)).

The SEC has consistently argued that "if the securities activities are engaged in for commissions or other compensation with sufficient recurrence to justify the inference that the activities are part of the person's business, [a person] will be deemed to be engaged in the business."[10] In addition to the regularity of business, the SEC have identified indications of broker activity that include "holding oneself out as a broker-dealer, recruiting or soliciting potential investors, handling client funds and securities, negotiating with issuers, and receiving transaction-based compensation." *See Anthony Fields*, AP File No. 3-14684, 2015 WL 728005, *18 (Feb. 20, 2015) (Commission Opinion). The receipt of "transaction-based compensation is one of the hallmarks of being a broker-dealer." *Gualario & Co.,* AP File No. 3-14340*,* 2012 WL 627198, *14 (Feb. 14, 2012) (Initial Decision).

The underlying concern that has led the SEC to consider transaction-based compensation as a hallmark for broker-dealer activity is that it represents a potential incentive for abusive sales practices. Having a financial stake in the potential transaction warrants registration with all of its investor protections, including the requirements of Regulation Best Interest.

## V. Expelled Individuals Can Resurface as Finders

Securities regulators work hard to weed out the bad actors in the industry and routinely expel individuals who have committed serious infractions and are not of good business repute. There is nothing impeding a former registered representative or investment adviser who has been barred from registration from simply becoming an exempt Finder. The Proposed Exemptive Order fails to address this serious issue. Should individuals previously barred from acting as a broker start soliciting clients into the private market, there is nothing securities regulators will be able to do about it under the Proposed Exemptive Order.

## VI. The Rulemaking Process Should Be Used In Lieu of the Proposed Exemptive Order

The Proposed Exemptive Order seeks to circumvent the formal rulemaking procedure. By circumventing the rulemaking process, the SEC is not required to perform any economic analysis of the impact of the exemption nor consider its impact on capital formation. Further, the SEC is not required to support its proposed policy with any actual evidence tying the proposal to the SEC's stated goal.

The SEC speculated that the proposal would benefit minority and women-owned businesses, but there is nothing in the proposal supporting that supposition and nothing in the Proposed Exemptive Order that would be specifically tailored to that purpose. More importantly, because of the SEC's lack of oversight of the private market, it would not have any way of evaluating the Proposed Exemptive Order's use or abuse.

The SEC proposes to adopt this radical policy change through an exemptive order, despite the fact that an alternative is available – working with FINRA and state securities regulators to adopt a regulatory regime tailored for these private market intermediaries. That is the approach that the Treasury Department recommended in its 2017 report, when it suggested adoption of "a 'broker-dealer lite' rule that applies an appropriately scaled regulatory scheme on finders." Similarly, that is the approach advocated by an American Bar Association Task Force in a 2005 report that was subsequently endorsed by the SEC's Advisory Committee on Smaller Public Companies, among others.

A modified broker-dealer regulatory framework that addressed the specific nature of entities that act solely as Finders would be more appropriate that wholly exempting such entities from registration. Subjecting such entities to standards of conduct, such as the FINRA suitability rules, communications rules, and supervisory rules, among other,

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[10] *InTouch Global, LLC*, SEC No-Action Letter (Nov. 14, 1995).

as well as Regulation Best Interest for activity that involves solicitation is appropriate and will ensure that investor protection is a priority alongside capital formation. Such a framework will also ensure that there is a Regulator that has the resources to regularly examine the entities engaged in this conduct to ensure that they are following the conditions set forth, and are not engaged in conduct which we have seen in the past – conduct aimed at exploiting the disparities of information in the private placement space at the expense of investors and retirees.
The Proposed Exemptive Order is not an appropriate vehicle to address the myriad issues related to unregulated Finders.

**VII. Conclusion**

The Proposed Exemptive Order will severely undermine investor protection and does nothing to protect small businesses from unscrupulous Finders. PIABA stresses and reminds the SEC of its primary objective of protecting investors. For all of the reasons set forth in this letter, the Proposed Exemptive Order should be withdrawn.

Respectfully submitted,

David P. Meyer, President
Public Investors Advocate Bar Association