UNIVERSITY OF MIAMI
SCHOOL of LAW

Investor Rights Clinic
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November 11, 2020

Ms. Vanessa A. Countryman
Secretary, Securities and Exchange Commission
100 F Street, Suite NE.,
Washington, DC, 20549-1090

Re: Release No. 34-90112; File No. S7-13-20
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

Dear Ms. Countryman:

The University of Miami School or Law Investor Rights Clinic ("IRC") appreciates the opportunity to comment on the U.S. Securities and Exchange Commission's ("SEC") proposed exemptive order addressing the regulation of finders.

I. Overview

As the only *pro bono* organization in Florida assisting investors of modest means, the IRC has witnessed the consequences of private offering fraud on unsophisticated and vulnerable investors. Despite the rules and regulations applicable to registered brokers, brokers have misrepresented IRC clients as accredited investors in order to qualify them to purchase high-risk, high-commission private offerings, resulting in catastrophic losses of retirement savings. The SEC now seeks to expand the availability of compensation in connection with private offerings to individuals not subject to any licensing requirements or regulatory oversight. While the IRC understands the necessity of creating a brightline rule for finders' activities, we are concerned that the SEC's proposed exemptive order does not adequately protect investors from the misconduct associated with soliciting individuals to invest in private markets.

An exemption for finders may be necessary for small issuers navigating a grey area of capital raising. Currently, there is a narrow space, created by SEC no-action letters, for individuals to engage in broker activity without registration.[1] In the no-action letters, the SEC has offered analysis based on several factors with no single factor being dispositive. A brightline rule with respect to finders' activities is overdue. However, in its final exemptive order, the SEC should limit the scope of its proposal to provide adequate investor protections, especially in light of the SEC's failure to increase the wealth thresholds in its recent update to the definition of accredited investors.

[1] *See Brumberg, Mackey & Wall PLC*, SEC No-Action Letter (May 17, 2010); *see Paul Anka*, SEC No-Action Letter (July 24, 1991).

II. Finders Should Be Required to Take Reasonable, Verifiable Steps to Determine Accredited Investor Status

Commissioners Allison Herren Lee and Caroline Crenshaw have recently remarked that "private offerings are not just less transparent, but also illiquid, and prone to fraud."[2] Accordingly, the SEC has generally limited unaccredited investors' access to private markets, and the proposed exemption is not available to finders who solicit unaccredited investors. Keeping in mind that the SEC's mission is to protect investors, however, the exemptive order should require compensated finders to have more than a "reasonable belief" that a prospective investor is accredited.[3]

In its final exemptive order, the SEC should require that finders take *reasonable, verifiable steps* to ensure that an investor is accredited as opposed to the finder having a mere reasonable belief. Taking reasonable steps to establish an investor's status as accredited is essential to providing adequate investor protection in private markets. Private markets "lack the traditional investor protections that attach to registration."[4] This lack of protection puts seniors and other vulnerable investors, who make up a substantial portion of the IRC's clients, at risk of fraud.

Moreover, our clients have little sophistication and investment experience and often trust those who present investment opportunities to them, and even licensed and registered brokers often abuse that trust. Even in the context of Tier I finders, issuers will rely to some extent on the "reasonable belief" of the finders that an investor is accredited when they offer to sell private securities to the finders' prospective investors in the first place. And regardless of the limitations on solicitation for Tier II finders, prospective investors will view presentations from Tier II finders as endorsements of the proposed investment opportunities. Additional requirements are necessary to prevent false qualification of accredited investors and to maintain adequate records of finders' interactions with prospective investors.

In view of the financial incentive for finders to "accredit" as many investors as possible, the SEC should require that finders provide issuers a written basis for their reasonable belief that a prospective investor is accredited. The requirements of this written record may include, for example, a description of the assets the finder believes to be sufficient to meet the wealth threshold of an accredited investor or the professional certification or credential that gives the investor accredited status. The writing that identifies the basis for the finder's reasonable belief as to an investor's status should then be delivered to the issuer for review and certification prior

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[2] Allison Herren Lee & Caroline Crenshaw, *Joint Statement on the Failure to Modernize the Accredited Investor Definition*, SEC (Aug. 26, 2020), https://www.sec.gov/news/public-statement/lee-crenshaw-accredited-investor-2020-08-26.

[3] *About the SEC*, SEC, https://www.sec.gov/about.shtml ("The mission of the SEC is to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation. The SEC strives to promote a market environment that is worthy of the public's trust.").

[4] *See Joint Statement on the Failure to Modernize the Accredited Investor Definition*, *supra* note 2.

to commencing the private offering to sell restricted securities to prospective investors identified by the finder. Requiring issuers' certification of their review of the accredited investor information provided by finders would add an additional layer of investor protection in an area of securities sales rife with investment fraud and incentivized by high commissions.

The SEC's proposed exemptive order would expand the availability of financial incentives to engage in fraudulent sales of private offerings. The SEC should provide a commensurate expansion of investor protection by requiring finders to take reasonable, verifiable steps and requiring issuers to certify its review of the written basis for the finders' reasonable belief that an investor is accredited.

III. The Final Exemptive Order Should Prohibit Finders for SAFEs

The SEC should not allow finders to identify investors of issuers offering Simple Agreements for Future Equity ("SAFEs") because issuers of these instruments are not obligated to repay money invested in these securities, which have no maturity date and do not accrue interest. Generally, these instruments were not created for retail investors. Instead, they were created for venture capitalists to invest in fast-growing start-ups.[5] Because SAFEs are substantially riskier to the investor than most other securities and are meant for venture capital investors, finders should not be permitted to receive compensation from issuers that are offering SAFEs. Under the proposed exemption, a finder's absence of licensing or registration and performance of salesman-like activity of especially risky instruments like SAFEs poses an undue risk to investors.

IV. The Exemption Should Be Conditioned on the Finder Filing Notice with the SEC

Tier II finders should be required to file notice of reliance on the proposed exemption with the SEC. Requiring Tier II finders to file notice creates an additional layer of oversight at little additional cost. This notice should mirror Items No. 1, 2, 4, 6, 9, and 15 on Form D.[6] Specifically, the notice should include the issuer's identity, the issuer's principle place of business and contact information, information regarding the issuer's industry, the type of security being offered, and specific information regarding the finder's compensation (similar to Item 12 of Form D).

V. Tier II Finders Should be Required to Make Written Disclosure to Investors

Rather than the oral disclosures contemplated in the proposed exemptive order, Tier II finders should make written disclosures to investors at the time of solicitation because it will

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[5] *Investor Bulletin: Be Cautious of SAFEs in Crowdfunding*, SEC (May 9, 2017), https://www.sec.gov/oiea/investor-alerts-and-bulletins/ib_safes ("[F]or the venture capital investor, it [is] more important to get the investment opportunity, and possible future opportunities, with the startup than it [is] to protect the relatively small investment represented by the SAFE.").

[6] *Form D: Notice of Exempt Offering of Securities*, SEC, https://www.sec.gov/about/forms/formd.pdf.

provide the investor important background information to help inform their investment decision at the earliest stage. Specifically, the proposed exemptive order provides that disclosure "should help to increase investor awareness of the scope of the finder's relationship with the issuer and potential conflicts of interest." The information required to be disclosed is material to investors' decisions and, thus, should be required to be provided to the investor in writing and should disclose the finder's compensation arrangement in the private offering. Moreover, the items required to be disclosed should be conspicuous and written in plain language. Allowing for the required disclosures to be buried in additional materials and language provided by the finder or allowing oral disclosure to satisfy the disclosure requirement would defeat the purpose of the disclosure. Finally, Tier II finders should be required to receive and maintain an acknowledgement of receipt of the written disclosure. An electronic confirmation of receipt of the disclosure should be sufficient.

Requiring written disclosure tracks the rationale for Regulation Best Interest.[7] Regulation Best Interest is intended to promote a higher standard of broker conduct and to enable retail investors to make informed decisions, in part through disclosure of conflicts.[8] Finders receiving compensation should be held to a similar standard of disclosure. Disclosure of the nature of the finder's relationship with the issuer, for example, promotes accountability and transparency, at little additional cost.

VI. Transaction-based Compensation Should Be Prohibited

The SEC has remarked that the "receipt of transaction-based compensation . . . is a hallmark of broker-dealer activity."[9] The SEC should continue to disallow transaction-based compensation for individuals who are not associated persons of a broker-dealer because it creates a "salesman's stake" in a potential sale of securities.[10] In this way, transaction-based compensation will encourage sales efforts on a finder's part and, thus, increased likelihood of misconduct without any of the protections of licensing and registration. While the exemption does not impose on finders a duty to act in the investors' best interest, it should deter and prohibit finders from acting out of unrestrained financial self-interest.

VII. Conclusion

The IRC is committed to protecting vulnerable investors. While we recognize and appreciate the SEC's move to create an exemption for finder's activities, we urge the SEC to narrow its final exemptive order in the interest of investor protection. Establishing standards for a finder's "reasonable belief" that an investor is accredited, filing notice of finder activities with

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[7] *See* Press Release, SEC Adopts Rules and Interpretations to Enhance Protections and Preserve Choice for Retail Investors in Their Relationships With Financial Professionals (June 5, 2019), https://www.sec.gov/news/press-release/2019-89.

[8] *Id*.

[9] *Brumberg, Mackey & Wall PLC*, SEC No-Action Letter (May 17, 2010).

[10] Allison Herren Lee, Regulating in the Dark: What We Don't Know About Finders Can Hurt Us (Oct. 7, 2020), https://www.sec.gov/news/public-statement/lee-proposed-finders-exemption-2020-10-07.

the SEC, requiring written disclosure of information that is material to an investor's decision, and prohibiting transaction-based compensation, taken together, will provide substantially greater investor protection, in line with the SEC's mission, while also balancing issuers' interests. Again, we thank the SEC for the opportunity to comment on its proposed exemptive order.

Respectfully submitted,

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