Zanbato

November 11, 2020

<u>Via email to rule-comments@sec.gov</u>

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

Re: Release No. 34-90112; File No. S7-13-20
<u>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</u>

Dear Ms. Countryman:

Zanbato Securities LLC ("<u>Zanbato</u>") appreciates the opportunity to provide its comments with respect to the above-referenced proposed exemptive order. Our comments relate to whether the scope of the proposed exemption should be expanded to secondary offerings, such as transactions facilitating the sale of equity by employees holding options or warrants.

As the sponsor of ZX, one of the largest trading platforms for private company shares, Zanbato understands the complexities involved in facilitating unregistered resale transactions. Based on our experience, we believe that permitting unregistered finders to engage in solicitation activities in connection with secondary sales could pose serious risks to investors and the integrity of the capital markets. The lack of transparency in the private markets, the potential for substantial information asymmetries between buyers and sellers, and the legal and contractual restrictions on unregistered resales require a licensed and regulated intermediary to ensure that investors are protected from possible fraud and misconduct.

1. The ZX Trading Platform

Zanbato, an independent broker-dealer registered with the U.S. Securities and Exchange Commission and a member of the Financial Industry Regulatory Authority, operates an alternative trading system supporting the institutional trading of private company stock. Zanbato recognizes that traditional venture capital exits no longer provide sufficient liquidity to private company shareholders. To fill this liquidity gap, top institutional investors today leverage secondary markets to manage their private company holdings. We are committed to providing market participants with a trusted, centralized transaction venue for liquidity and price discovery. By aggregating liquidity across its membership of leading banks and broker-dealers, Zanbato de-fragments private markets, thereby ensuring that a full order book is available to participants and increasing the odds of moving large positions quickly and while preserving client confidentiality. While the late stage venture-backed companies traded on ZX have valuations averaging from hundreds of millions to tens of billions of dollars and the average ticket size on ZX is over $10 million, our observations about the important role that registered intermediaries play in mitigating the risks of unregistered secondary sales, are equally applicable to secondary transfers of shares of small and emerging companies.

2. Registered Intermediaries Mitigate Valuation Risk

Individuals seeking to sell private company securities often have limited information on which to determine the price for the offered shares. While many sellers received their shares as compensation for services provided to the issuer, unless the seller is a member of the issuer's senior management, he/she is unlikely to have access to the issuer's current financial information or data about recent resale transactions. Similarly, unless an early investor in a private company negotiated information rights in connection with its investment, the investor may not have insight into the issuer's current business plan or finances. Many issuers are unwilling to provide information to buyers and sellers for the purpose of facilitating transfers. Moreover, the price of the securities being offered for sale will vary based on the type and class of the shares, the number of shares offered, the contractual rights and obligations that adhere to the shares, and whether those rights are transferrable. The lack of issuer-provided information and the variations in the shares themselves make it very challenging to value private company shares and are one reason why secondary transfers tend to be extensively negotiated.

The proposed exemption would permit "Tier II Finders" to engage in certain solicitation-related activities, while prohibiting those finders from providing advice as to valuation or the advisability of a securities transaction. This limitation is likely to harm investors seeking to engage in secondary transactions. Advice on valuation is crucial given the limited information available and the information asymmetries that exist between sellers and buyers in the private markets. While in certain instances the seller may possess material non-public information about the issuer that is not available to the purchaser, in other situations, a sophisticated purchaser, through its contacts and diligence, may have better information about the issuer than the seller. A licensed intermediary has the ability to engage in price discovery and provide advice to its customer about the valuation of the offered shares and the potential risk-reward tradeoffs of the transaction. Assisting their customers in finding the most favorable terms of execution for a transaction, including price, is a core function that brokers provide in markets. Allowing solicitation by unlicensed finders magnifies the risk that investors in private company securities will not transact on an informed basis at the best possible price.

3. Registered Intermediaries Mitigate Execution Risk

In Zanbato's experience, matching buyers and sellers of private company shares is the easiest part of the process – the real challenge is closing the resale transaction. Close rates on transactions in the private secondary markets have historically been understood to be less than 5%, reflecting the extreme difficulties in finding a counterparty, documenting a transaction to the issuer's standards, and closing a transaction. Private company shares are often encumbered by complex rights of first refusal and other contractual limitations on their transfer or sale, requiring negotiation with the issuer. For example, the issuer's governing documents may require the issuer's prior written consent to a transfer, or may provide the issuer's board of directors with discretion to approve or disapprove the registration of stock transfers (effectively imposing a consent right). Failure to comply with these contractual limitations can result in the transfer being void. Without the assistance of a licensed intermediary to guide the parties through the transfer process, assist in obtaining the issuer's consent, and smooth the path to closing, the likelihood that a transaction will close is slim.

4. Registered Intermediaries Mitigate Risk of Securities Law Violations

Broker-dealers play a critical role in helping prevent illegal, unregistered resales of restricted securities into the public markets. Before facilitating an unregistered resale for its customer, a broker is required to take reasonable steps to ensure that the transaction qualifies for an applicable exemption from registration under the Securities Act of 1933. Among other things, brokers are expected to determine when and how the seller acquired the shares, whether the seller is an affiliate of the issuer, the period of time that the seller has held the shares, and what percentage of the outstanding shares of the issuer are owned by the seller. Each broker-dealer is required to have policies and procedures designed to avoid the firm's participation in an unregistered distribution. The involvement of a regulated entity in the resale transaction increases the likelihood that the transaction will be conducted in compliance with the securities laws, and also allows regulators to more easily identify potential unregistered distributions and fraudulent transactions. If finders are permitted to engage in solicitation for secondary offerings, unscrupulous issuers will have one fewer roadblock to prevent them from accessing the public securities markets through illegal, unregistered distributions.

5. Registered Intermediaries Mitigate Risk of Fraud

In light of the multiple risks posed by unregistered resale transactions, having an intermediary that is subject to regulatory supervision and is bound by applicable standards of conduct is vital for investor protection. Where the potential buyer or seller is a "retail customer," Regulation Best Interest applies to a broker's recommendation to its client to engage in a sale of private company securities. The broker is required to exercise reasonable diligence, care and skill when making a recommendation and have a reasonable basis to believe the recommendation is in the best interest of the particular retail customer based on that retail customer's investment profile and the potential risks, rewards, and costs associated with the recommendation. In addition, the Bank Secrecy Act requires broker-dealers to develop and implement AML compliance programs. Among other things, brokers are required to verify the identities of their clients, ensure that their clients are not on the OFAC list, and monitor for and report suspicious transactions. These obligations help mitigate the risk that a resale transaction could be used to facilitate money laundering. In contrast, a finder would not be required to conduct diligence on the issuer or its client, or to act in the best interest of its client. Although the terms of the proposed exemption would require the finder to disclose material conflicts of interest, nothing would prohibit the finder from placing its own interests ahead of its client's interest. Permitting finders to solicit in the private markets without regulatory oversight and absent any standard of conduct could significantly increase the number of fraudulent transactions.

The growing secondary market for private company securities is evolving rapidly, with firms ranging from small, specialized brokerages to global institutions seeking to provide matching and transaction services to buyers and sellers of unregistered securities in compliance with applicable law, rules and regulations. Expanding the proposed exemption to secondary offerings would be a drastic step in the wrong direction.

Zanbato appreciates the opportunity to submit its comments. If you have questions, please do not hesitate to contact me at [redacted].

Best regards,

Gregory L. Wright
President and Head of Banking