NETWORK 1 FINANCIAL
SECURITIES, INC.

Also sent electronically to: rule-comments@sec.gov

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

Reference: File Number 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:

Please accept this Comment Letter to the SEC's proposed new rule addressing "finders", to which we ask the question whether having Unlicensed Brokers is a Good Idea?

The Securities and Exchange Commission (the "Commission") has recently proposed a rule change that would, under limited circumstances, allow individuals – who are neither owners nor registered representatives of Broker/Dealers – to act as intermediaries for issuers, finding investors who will exchange investor money for a stake in the issuer's business. Historically, this intermediation was performed by broker-dealers that are registered with the Commission and directly regulated by a self-regulatory organization like FINRA. The Commission's proposed rule would effectively eliminate regulation precisely where effective regulation is most needed: At the point of contact between an investor and the middle man for the issuer who wants and needs the investor's money. Historically, this middle man was the Broker/Dealer and its brokers. The SEC's proposed rule change would change this in a meaningful way, but not for the benefit of investors. By allowing a private person, a "finder", to act and look like a broker in the eyes of a potential investor; and, giving a regulatory "pass" to this finder with the unrealistic expectation that this "finder" will only "introduce" the issuer to an investor but will not recommend that the investor part with his capital in exchange for issuer's securities – will not sell, in other words – presumes that "finders" are angels by nature.

Where is there common-sense support for this presumption?

We respect the fact that the Commission's "finder" proposed rule change is a response to the lack of capital for small to mid-size issuers. But, in our view, this proposed rule change would eliminate the decades of regulation that protected the lawful sale and placement of private issuers that benefited investors and issuers, alike.

There is, in my admittedly cynical view, a reason for the SEC's action: The regulations currently in place and, more importantly, how they are being enforced, have all but eliminated the ***small*** broker-dealer from participation in private markets that have, historically, benefited emerging companies. Again, in my view, the SEC's proposed rule will be another attack on the business of the small Broker/Dealers in America.

My recommendation would be not to eliminate the regulation and oversight of broker-dealers that participate in these private offerings but to adjust regulations to enable broker-dealers in these markets to be able to continue to conduct and encourage this business. After all, the investors who exchange their capital for a stake in small businesses are accredited investors. Accredited Investors can be risk-takers, and the SEC rules and regulations already provide more than adequate protection for these investors.

And so, back to the "finder" rule proposition. The first assumption of the SEC's proposal is that a "finder" will introduce a transaction to an investor but will not recommend and will not sell the private offering security. This concept is completely naive as to what happens in the real world. Contrary to what may be hoped for, the finder *will* explain the nature of the issuer's business; *will* explain the reasons for which the issuer needs the investor's capital and how the investor's capital will be put to good use (and of course, what this will ultimately mean for the investor's return on his investment), *will* convince the accredited investor to accept the material from the issuer; and *will* advise the investor to participate in these transactions. In short, the finder will encourage the investor to invest.

Every business person knows that, in order to earn his fee, the finder will need to ***sell***; and, the first thing the finder will "sell" to the investor is a reason to accept the advertising materials; after that, the finder will see to it that any questions that the investor might have about the materials and the offering will be promptly answered, if not by the issuer, then certainly by himself. In short, the finder doesn't start acting like a saint just because he isn't registered.

Who is going to monitor this interaction between finder and investor? Who is going to make sure high-pressure sales tactics are not going on when a finder reaches out to an investor?

Where is the oversight going to come from? Under the current regulatory regime, all Broker/Dealer interactions, emails, letters and materials are reviewed by the firm's compliance department. On top of that is the oversight or regulation by FINRA. These are done for investor protection. Where and how will this oversight function be carried out for the unregistered finders?

The proposed rule talks about the finder exercising a "reasonable belief" that an investor is accredited. But let's compare the exercise that a Broker/Dealer is currently required to undertake when evaluating whether an investor is, in fact, accredited and the risk when a Broker/Dealer fails in its duty:

- A Broker/Dealer must know the investor's financial position or at least make sure the Broker/Dealer has a true financial picture of the investor; and, if the Broker/Dealer fails in this exercise, the Broker/Dealer and its registered representative risk losing their licenses and livelihood because they have engaged in a solicitation in violation of securities regulations.

- A finder's only obligation, or so it seems, is to infer that, because the investor lives in a great neighborhood, the investor is *de facto* accredited. Is this the "reasonable belief" to which a finder is going to be judged? In the absence of imposing any additional obligation to know more about the investor (that is, beyond the investor living in a great neighborhood), where is there protection for investors? Afterall, unlike the broker and his firm, the finder faces no risk to losing a securities license, and therefore livelihood.

In short, the finder and Broker/Dealer are two different animals. Oversight over the Broker/Dealer is intense. Oversight over the finder is relaxed to none. Risk to the Broker/Dealer for failure to fulfill duties is dramatic (loss of licenses that leads to loss of livelihood). Risk to the finder, frankly, is rather difficult to assess because the finder has no license to lose and acting as a finder has no risk of losing a livelihood. Indeed, if the finder is acting as a finder on a full-time basis, then the finder should need to take and pass FINRA registration exams and register as a broker with a Broker/Dealer.

The practical problem that comes with relaxing the securities laws in order to allow finders to do the job that an SEC registered Broker/Dealer should be doing shines a bright light on real-life consequences underling the SEC's proposed solution for improving micro-cap company participation in the capital markets: Finders, being participants in the private issue markets, with next to no meaningful regulation and next to nothing to lose, are dangerous to potential investors. Seriously, who is going to police the finders to make sure the investors solicited are accredited? The Issuer? That's like having the fox watch over the hen house.

Another area that is a concern is the non-definition of what compensation these finders may receive. Can finders earn 20% of monies raised?

More compelling is this question: Can finders own 20% of the company for whom they just referred investors? Conflicts of interest have been the primary concern of regulators for the last twenty or more years, and yet it seems that finders may find themselves given a pass when it comes to the conflict of interest concerns of regulators. Sure, there will be "conflicts" disclosures. But again, finders, being participants in the private markets, with next to no meaningful regulation and next to nothing to lose, are not likely to be negatively impacted by the disclosures they make – but the investors will be.

In contrast, Broker/Dealer compensation is reviewed and can be challenged by FINRA if deemed excessive. Equally important, Broker/Dealers are required by rule to follow different compensation rules if they are shareholders of the Issuer.

This new SEC proposed rule opens an important door to investor exposure to investment risk that the investor would not face if the investor had dealings with a Broker/Dealer instead of a finder.

The area of due diligence should be a major concern for regulators but, at least at this point, appears to be overlooked to an important degree. A Broker/Dealer, when acting as a placement agent must review all issuer material it uses and make sure the disclosures and projections are reasonable and fair. Should the issuers material be fraudulent, the investor is protected by the legal actions and arbitration against the Broker/Dealer and its representative.

It is noted that there appears to be little discussion in the proposed rule about who will review issuer (i.e., advertising) materials before the finder passes these materials to investors. Will the SEC protect the investor by its review of issuer material before the finders use them? Or do we leave this up to the Issuer? (another "fox in the hen house" issue).

The private capital market for smaller businesses would be better served by the smaller independent investment banks if the current regulations were clarified and enforced on a reasonable basis. A way that doesn't make the broker-dealer feel like they are always under the microscope and could lose everything if they participate in this particular market.

Special Purpose Vehicles (SPV)

What also strikes me is how this rule change will affect the growing market of "Special Purpose Vehicles" (SPV) and their role in distributing private shares of "Unicorns"[1] to the investing public.

This market is growing and extremely active. In the SPV marketplace, the individual accredited investor buys a security (the SPV) that itself invests in a private company's shares purchased from an insider or shareholder. The shares purchased by SPV's are not subject to registration or private placement information on the underlying shares purchased that can be disclosed to an investor.

Currently, the marketers of these products, namely, Broker/Dealers, have both regulatory responsibilities as well as litigation liability in seeing that the SPV is properly structured and compliant with rules that govern SPV's. Broker/Dealers have an obligation to make sure the underlying company being purchased has sufficient information available to the public so that the investor is able to understand the investment.

At this juncture, the SPV marketplace is subject to regulatory oversight to the extent that the marketer, that is, the Broker/Dealer and its registered representatives who sell SPV's, is *directly* regulated by FINRA and, therefore, indirectly by the SEC (although the SEC can itself step into the arena, exercise its jurisdiction, and pursue parallel enforcement proceeds against a wayward Broker/Dealer or broker).

[1], "Unicorn" is a term coined by Aileen Lee, a venture capitalist, to describe privately held tech startups, especially in Silicon Valley but now elsewhere, that have achieved a valuation of $1 billion or more.

Now enter the finder in this SPV market place under the SEC's proposed finder's rule. Marketing of these SPV investments will cease to have a direct regulatory oversight as FINRA has no jurisdiction over the finder. This is definitely an area of extreme concern.

Under this new regime, founders of an SPV will have their own sales force (i.e., finders) to market their own partnerships.

Does this really sound like an idea that protects investors?

The US Markets have excellent laws and regulations that protect investors. But, when interpretation of securities rules over reach legitimate business interests (while intending to do good), and when enforcement of these rules seem logical on paper (again, intending to do good) but in fact stymie free enterprise in practice, the concurrence of these two events lead to the destruction of the capital markets. The well-intentioned new finder's proposed rule appears to be an exemplar of this concurrence. The abandonment of *existing* rules that have for nearly a century spawned free enterprise in the capital markets, and the creation of a kind of maverick finder category grafted onto existing rules, is the exact opposite of the kind of action that should be taken at this time.

<u>Best Interest Rule</u>

The recent introduction of the "Best Interest" rule does not, at least to me, mesh with the Finders Rule now being proposed. In fact, the "Best Interest" Rule and the new "Finder's Rule" not only seem to contradict one another but seem to be the creation of two regulators in different universes.

At a time when the SEC has promulgated a rule (the "Best Interest" rule) that has the effect of holding registered representatives responsible, in an almost fiduciary capacity, for presenting investments to the public that are in their best interests, the SEC is now coming forward with a new proposed rule (the "Finder's Rule"), allowing non-registered finders having duties when dealing with investors, apparently justified by almost a religious belief that the unregistered finder *will not* explain the nature of the issuer's business; *will not* explain the reasons for which the issuer needs the investor's capital and how the investor's capital will be put to good use; *will not* try to persuade the investor as to what this ultimately means for the investor's return on his investment; *will not* convince the accredited investor to accept the material from the issuer and to invest; and *will not* recommend and advise the investor to participate in these transactions – premised on the expectation that the finder will act responsible once the burden of regulation has been taken off his shoulders. This defies human nature and common sense.

The better course of action is to ask the question: What new rules can be created to make use of the small investment banking firms for greater efficiency in bringing investor dollars to small business, while at the same time maintaining regulatory enforcement over matters that are truly injurious to the investor.

This is exactly my point, that the laws and enforcements make it difficult to serve the private issuers by the small investment bankers. The solution is not to allow individuals to act like a stock broker without being registered. Rather, the focus of regulatory action should be on encouraging bankers to do what they do best for smaller companies in desperate need of capital under a regulatory and enforcement environment that makes good business sense for Issuer and investor protection.

It is my view that this new finder proposal is the exact opposite of the actions the SEC should be taking to encourage capital formation for small private issues.

It is my opinion we will all be very unhappy with the implementation of this rule, should it be adopted.

Sincerely,

Damon D. Testaverde
Chairman