November 12, 2020

Mrs. Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: 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 (Release No. 34–90112; File No. S7–13–20).

Dear Secretary Countryman:

Better Markets[1] appreciates the opportunity to comment on the above-captioned notice ("Proposal" or "Release") noticed for public comment by the Securities and Exchange Commission ("SEC" or "Commission"). The Release,[2] if approved as noticed, would create a new category of a financial intermediary that will serve between investors and issuers without registering with any regulatory body and without becoming subject to any rules or regulations (including, licensing, certification, continuing education, record-keeping, supervision, etc.) that such registration brings about.

Given the enormous investor protection risks and the unconvincing rationale presented in the Release (that the exemptions would spur meaningful and socially useful capital formation), we strongly oppose the creation of these unqualified, unlicensed, and unpoliced categories of intermediaries. The Commission must withdraw this Release.

Description of the Proposal

The Commission is proposing to create two new classes of unregistered, unlicensed and unpoliced financial intermediaries that would operate between investors and certain issuers of unregistered securities. Specifically, the Commission is proposing to exempt two classes of "Finders," a "Tier I" and "Tier II" Finders. The proposed exemption for Tier I and Tier II Finders would be available only where:

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1 Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans' jobs, savings, retirements, and more.

2 *See*, Release No. 34–90112; File No. S7–13–20, 85 Fed. Reg. 64542 (October 13, 2020) *available* at https://www.federalregister.gov/documents/2020/10/13/2020-22565/notice-of-proposed-exemptive-order-granting-conditional-exemption-from-the-broker-registration.

- The issuer is not required to file reports under Section 13 or Section 15(d) of the Exchange Act, and therefore issues unregistered securities;
- The Finder promises to not engage in general solicitation;
- The solicited or potential investor is an "Accredited Investor" or the Finder has "reasonable belief" that the investor in question is an accredited investor (but the Finder does NOT need to verify the status);
- The Finder provides services pursuant to a written agreement with the issuer that includes a description of the services provided and associated compensation;
- The Finder is not an associated person of a broker-dealer, and;
- The Finder is not subject to statutory disqualification (the so-called "bad actor" ban).

Both tiers would be permitted to receive transaction-based compensation from the issuer. Both tiers are prohibited to "handle customer funds or securities or bind the issuer or investor; participate in the preparation of any sales materials; perform any independent analysis of the sale; engage in any ''due diligence'' activities; assist or provide financing for such purchases; or provide advice as to the valuation or financial advisability of the investment."[3] The Proposal then further sets conditions that apply separately for Tier 1 and Tier II Finders.

Tier I Finders: For Tier I, the Finder must meet the above conditions, and his or her activities must be limited to: "providing contact information of potential investors in connection with only one capital raising transaction by a single issuer within a 12-month period, provided the Tier I Finder does not have any contact with the potential investors about the issuer. The contact information may include, among other things, name, telephone number, email address, and social media information."[4]

Tier II Finders: For Tier II Finders, the Commission is proposing to permit a wide array of previously unpermitted activities that Tier II Finders could engage with no registration or regulation. Tier II Finders could engage in solicitation-related activities on behalf of an issuer, such as:

(i) Identifying, screening, and contacting potential investors;
(ii) Distributing issuer offering materials to investors;
(iii) Discussing issuer information included in any offering materials, provided that the Tier II Finder does not provide advice as to the valuation or advisability of the investment, and;
(iv) Arranging or participating in meetings with the issuer and investor.[5]

A Tier II Finder would need disclose to a potential investor, prior to or at the time of the solicitation: "(1) the name of the Tier II Finder; (2) the name of the issuer; (3) the description of the relationship between the Tier II Finder and the issuer, including any affiliation; (4) a statement that the Tier II Finder will be compensated for his or her solicitation activities by the issuer and a description of the terms of such compensation arrangement; (5) any material conflicts of interest resulting from the arrangement or relationship between the Tier II Finder and the issuer; and (6) an affirmative statement that the Tier II Finder is acting as an agent of the issuer, is not acting as

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3 *See* Release at 64549.
4 *See* Release at 64548.
5 *See* Release at 64548.

an associated person of a broker-dealer, and is not undertaking a role to act in the investor's best interest."[6]

Importantly, the Commission would permit the Tier II Finder "to provide such disclosure orally, provided that the oral disclosure is supplemented by written disclosure and satisfies all of the disclosure requirements listed above no later than the time of any related investment in the issuer's securities."[7] Finally, the Tier II Finder "must obtain from the investor, prior to or at the time of any investment in the issuer's securities, a dated written acknowledgment of receipt of the Tier II Finder's required disclosures."[8]

The Commission claims—providing nearly no data—and repeats the claims of self-interested parties (again, not accompanying such claims with Commission's own meaningful analysis or validation) that smaller private companies would take advantage of the Finders exemptions to satisfy their on-going funding needs. And that, supposedly, these companies have historically had difficult time attracting the services of traditional (*i.e.,* registered and regulated) broker-dealers.

General Comments

Companies with promising prospects—that offer needed products or services for their customers, that reward their employees well, and that pursue their profits without imposing negative externalities upon others—indeed do deserve access to reliable and affordable financing. Companies that are women- and/or minority-owned deserve particular attention from policymakers who would offer targeted and effective regulatory measures that spur economic growth, job creation, and community empowerment. Similarly, investors indeed need diversified investment opportunities offered by companies that disclose robust financial data and other material information that would give confidence to investors. But the radical, ideologically-driven, and unsupported-by-evidence Proposal would NOT address any of these pressing public policy challenges. We believe, the Proposal would indeed risk exacerbating these challenges, harm investor protection and consequently harm capital formation.

The solutions proposed in this Release—that of making it easier for private companies to remain private and employ the services of unqualified, unlicensed, and unpoliced intermediaries—will harm capital formation. In our view, permitting Tier II Finders to operate as proposed would mean that US investors will have fewer public companies to invest in, the securities markets will have more companies with illiquid securities, price discovery of all securities will suffer, job destruction and asset-wasting will become even more pronounced, and investor harm will increase. The result of these deregulations would be that more investors who cannot fend for themselves will be harmed and lose confidence in the markets and regulators, and withdraw further from such markets, which in turn would harm capital formation and economic vibrancy. And thus, SEC's efforts to facilitate capital formation for a few companies that are failing to attract funding will in fact harm capital formation for the rest of the economy.

6 *See* Release at 64548.
7 *See* Release at 64549.
8 *See* Release at 64549.

The Commission offers insufficient evidence showing an actual need for financing. It refers to self-serving and unsubstantiated claims by trade associations, advisory committees or forums that have a long history of consistently advocating for deregulation as a panacea for all their business or operational ills. To the contrary, there is evidence that, in fact, there is glut of funding, and that too much money is chasing too few investment-worthy companies. The Commission assumes, without providing data, that deregulating the broker-dealer profession and creating two new classes of unqualified, unlicensed, and unpoliced classes of intermediaries would somehow spur capital formation, and ease viable and growing companies' access to financing.

It also noteworthy how much of the Release is based on conjecture and assumptions. The lack of robust data and actual concrete information is glaring. The Commission simply must undertake a serious data gathering process and answer some fundamental questions before it can create two new classes of unqualified, unlicensed, and unpoliced financial intermediaries. The Commission owes to its tripartite mission of investor protection, facilitation of capital formation, and maintenance of fair and orderly; and to the constituency it is statutorily mandated to serve basic and convincing answers to the following questions:

1. Are high-growth and/or promising companies having difficulties accessing funding?

2. Are retail investors asking for or need access to exempt offerings?

3. Do high-growth and/or promising companies prefer funding from *retail* investors rather than institutional investors, venture funds, and others that are already amply available?

4. If there are indeed some promising companies that cannot access to needed capital to grow, what are the reasons the smart money is shunning them?

5. Why are these promising companies having challenges raising funds from friends and family, angel investors, local and national banks, credit unions, from facilities Small Business Administration sponsors or other federally backed facilities or state and local government programs?

6. If these high-growth and promising companies and intermediaries that cater to them particularly prefer funding from retail investors, what are the reasons?

7. How do those who invest in exempt offerings fare? Will *retail* investors do better or worse compared to sophisticated investors investing in the same exempt offerings? Will retail investors fare better investing in exempt offerings versus public offerings?

The Release is essentially silent on all the above pertinent questions. This Release, taken together with the Commission's several other deregulatory proposals of the previous three years—sold in the name of capital formation—would expose retail, financially unsophisticated investors (who often lack the wherewithal to understand risks associated with investing in dark private markets and/or lack the deep pockets to withstand higher-than-normal probability of investment loss) to the risks of investing in companies that have funding challenges and prefer to not disclose information about their financial condition or growth prospects. These Proposals—marketed in the name of increasing investment opportunities for retail investors—would, more often than not, enable intermediaries to reap huge commissions by peddling unsuitable investment products to unsuspecting investors and allow companies and their executives to plunder through the hard-earned savings of ordinary Americans with no real benefit of sensible and sustainable economic growth. We are left to conclude that the Commission has naively bought the hype peddled by intermediaries who stand to benefit from the rents in their role as middle-men or so-called entrepreneurs who often engage in job destruction and wasting of assets.

Commission Fails To Prove Its Central Premise, That: Deregulating Finders Will Spur Capital Formation.

The Commission offers no evidence to show that currently Accredited Investors are clamoring to invest in these small issuers who cannot even afford to engage a duly registered and licensed broker-dealer. The Commission offers no evidence (or even a compelling argument) to convince us that companies that disclose at best stale information about themselves and their prospects, or at worst, are total frauds, could attract informed investments from Accredited Investors. The Commission offers no convincing argument why companies that have been turned down by their friends and family; angel investors; local or national banks; private equity or venture funds; federal or state financing programs; and other "smart money," should be sensible investment for Accredited Investors such as dentists, car mechanics, or firefighters who happen to own a house or two but know near-nothing about the risks associated with investing in illiquid, unregistered, and possibly worthless unregistered securities. Why is it good public policy to enable unqualified, unlicensed, and unpoliced Finders to peddle unsuitable financial products to investors who do not have the financial wherewithal or necessary sophistication to withstand the highly-probable loss associated with unregistered securities? The Release fails to answer this fundamental question.

Despite data showing that companies which are viable and investment-worthy have no significant challenge finding and raising necessary funding, the Commission, throughout the Release, seems to suggest that access to capital is still curtailed. The fatal flaw in such a suggestion is that the Commission fails to distinguish between investment-worthy companies and those that have little to no prospect of ever returning a profit for their shareholders. It is not unreasonable to assume that "in our current glut of capital, firms that still cannot attract capital from institutional or high-net-worth investors are likely the smallest firms with the very worst prospects, which are wholly unsuitable investments for retail investors."[9]

Given this glut of funding[10] (including, historically low levels of interest rates which cause lenders and investors to compete to find viable borrowers/issuers and the multiple COVID-19-related federal and state financing programs available to viable companies), companies that have challenges finding investors or financing perhaps are facing such challenges because their business prospects are not promising. These companies would need to have been denied by sophisticated

9 *See* Elizabeth de Fontenay testimony ("de Fontenay Testimony") before House Financial Services Committee, Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets, "Examining Private Market Exemptions as a Barrier to IPOs and Retail Investment," p.4, September 11, 2019.

10 *See* also Rick Fleming, Investor Advocate of the SEC, Comment Letter (Investor Advocate Letter), July 11, 2019, available at https://www.sec.gov/comments/s7-08-19/s70819-5800855-187067.pdf, p.5.

investors and those who know the business or company's executives well. Enabling these companies to resort to paying excessive fees to Finders would only feed the Finder's "salesman's stake" and incentivize him or her to target the selling of such unregistered and unsuitable products to the least-informed investors. Put another way, all the "smart money" would need to decline investing in such a company for it to make economic sense to hire expensive and unscrupulous Finders who in turn would solicit least-informed investors. These are all the wrong incentives that a regulator like the Commission is charged to countervail, and certainly NOT enable.

<u>Lack of Verification of Accredited Status Would Invite Abuse.</u>

The Proposal would permit the unqualified, unlicensed, and unpoliced Tier II Finder to target for solicitation investors that he or she reasonably believes is an Accredited Investor without any verification or validation. The Proposal offers no guidance how such a belief may be formed or substantiated. It is not far-fetched for us to assume that a Finder could reasonably claim that if one dentist or car mechanic he or she knows is an Accredited Investor based on income or asset threshold test, then all dentists or car mechanics can be reasonably assumed to be Accredited Investors. This scenario is all the more likely given that Finders would not need to hold any financial intermediary license, and therefore their knowledge of the evolving definition of Accredited Investor would be limited.

The need to permit Finders to dispense with investor status verification is not supported with any specific data or analysis in the Release. And in fact, there is no persuasive reason why requiring the validation of the investor status is burdensome. We are not aware of any evidence—and none is offered in the Release—that the current investor status validation rule under SEC Rule 506(c) for Regulation D is burdensome. Given this sensible and workable verification mechanism available to the Commission, and the industry practices that have comfortably adapted to these requirements, it is unacceptable that the Commission would not require that issuers or Finders acting on their behalf that choose to solicit unregistered securities to investors to validate the status of the investor in accordance with minimum guidelines and standards.

The Commission has also failed to strike the right balance between the speculated burden on issuers or Finders versus the very real threat that the wrong type of investor may become subject to the solicitation of unregistered securities. While it may be sensible from a regulatory perspective not to hold an issuer or Finder liable when they are being actively lied to by an overzealous investor who is willing to falsify his or her way into an investment offering, it is much easier to see countless other scenarios where an investor is confused into signing a self-certification form that follows an incomprehensible fine-print on a webpage or a pile of disclosure documents. Given the intent to maximize participation and returns, it is only reasonable to expect that issuers and Finders will design mechanisms that maximize self-certification.

<u>Commission Fails to Show that Accredited Investors Want Or Need To Invest In Small Issuer Dark Markets.</u>

The Commission astonishingly and purposefully refuses to acknowledge in the Release its statutory mandate of investor protection, and coldly opens the Release with the following sentence: "The Commission's mission includes facilitating capital formation—not only for public companies, but also for the small businesses that are active participants in our private markets."[11] That is it. There is no follow-on mention of the Commission's other, and many would say, primary, mission of investor protection. This shocking omission does not absolve the Commission of its obligation of investor protection, however. Therefore, investors deserve to know how they will fare if they invest in the unregistered securities peddled by Finders. But the Commission offers no evidence how investors (be they Accredited or non-Accredited) currently fare when investing in these kinds of exempt offerings. In fact, given their very nature of unregistered offerings, the Commission has admitted that it lacks evidence about their performance.

Nothing else in the Release attempts to answer the fundamental question: Given the SEC's mandate of investor protection, how will investors fare when they invest in exempt offerings peddled by Finders? These offerings have scant information about the issuer and the securities themselves—to the extent they can even be traded—are illiquid. Finally, many Accredited Investors would be at a disadvantage compared to deep-pocketed and sophisticated investors who have ability and leverage to gain more information. This informational asymmetry would mean that when a company issuing the exempt offering is in trouble, the sophisticated investors would be able to detect it (or know) sooner and liquidate sooner, leaving the non-sophisticated Accredited Investors further disadvantaged.

As highlighted by the letter from North American Securities Administrators Association, these exempt offerings are particularly risky. The letter discusses the scandal relating to the Woodbridge Group of Companies:

> "Approximately 8,400 investors—mostly elderly persons who qualify as accredited investors solely due to retirement savings amassed over a lifetime—lost an estimated $1.3 billion in the Woodbridge Group of Companies private placement fraud. One of the reasons that this scheme grew so large was the involvement of persons acting as finders. In March, the Commission brought unregistered broker-dealer charges against three of the top agents who sold or assisted others in selling about $444 million in Woodbridge securities to investors in 40 different states. That is nearly one-third of all of the securities sold in the entire Woodbridge operation. The Commission alleges that these three organized cold calls and lured investors through email and in-person meetings where Woodbridge's sales and marketing materials would be disseminated. These individuals, performing precisely the same sort of unregulated activities that the Commission proposes for finders, were rewarded handsomely for their effective solicitation strategies, reaping over $2.75 million in transaction-based compensation beyond their salaries in a short three-year period."

We urge the Commission to heed the advice of its partners, the states' securities regulators who are often the front-line regulator in the unregistered securities markets and often the only protectors of seniors.

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11 *See* Release 64542.

At a bare minimum, the SEC must—before creating new classes of unqualified, unlicensed, and unpoliced financial intermediaries who would expose currently unsophisticated Accredited Investors or worse, non-Accredited Investors (using the excuse of "reasonable belief") to the barrage and peddling and solicitation of unregistered offerings—definitively know that these investors, given their financial and other limitations, would in fact do better when investing in unregistered offerings versus what they could achieve, for example, by investing in the public markets or low-cost market index funds.

The problem is further exacerbated by the fact that today there many thousands of investors who have become Accredited Investors solely due to inflation. In 1983, only 1.6% of U.S. households qualified as Accredited Investors, whereas today, 13% do so. This should give concern to the SEC as there may indeed now hundreds of thousands of investors who have become qualified as Accredited Investor solely on the virtue of inflation of their asset prices but who otherwise lack necessary financial sophistication to carefully weigh the risks associated in investing in exempt offerings. These newly minted Accredited Investors are often seniors with diminishing mental abilities and other vulnerabilities, and the SEC should devote its regulatory attention to the protection of these investors, and not attempt ways to dangerously expose them to the peddling of Finders.

Conclusion

We hope the Commission finds our comments helpful. The Commission must withdraw this patently anti-investor Release and instead focus on protecting and empowering today's investors so they can make informed investment decisions and participate in meaningful and socially useful capital formation.

Sincerely,

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