North Capital Private Securities Corporation
[redacted]
Salt Lake City, UT 84047
[redacted]

November 11, 2020

Securities and Exchange Commission
Via E-Mail

File Number S7-13-20

Dear Sir or Madam:

North Capital Private Securities Corp. and Public Brokers LLC are both SEC-registered broker-dealers focused on private placements and other exempt securities offerings. Both firms are wholly-owned subsidiaries of North Capital Investment Technology Inc., a financial technology company focused on improving the access, liquidity, and transparency of exempt securities through the development and deployment of technology infrastructure.

We appreciate the opportunity to comment on the exemption from broker registration proposed by the Commission, to allow unregistered "finders" to assist issuers with raising capital in private markets from accredited investors.

While we share the Commission's stated goal of making private capital raising easier and more seamless for issuers, this proposal would harm investors, undermine the existing regulatory framework for broker-dealers, and create a grossly inequitable playing field for registered firms and their licensed personnel.

Background

The purpose of the Securities and Exchange Commission is to protect investors, maintain fair, orderly and efficient markets, and facilitate capital formation.[1] This mandate is carried out via a regulatory framework that includes direct inspection and indirect regulation through the Commission's supervision of FINRA, a private regulatory body that writes and enforces rules governing the activities of all member broker-dealer firms and registered brokers in the United States.

[1] SEC Website – "What We Do" - https://www.sec.gov/about/what-we-do.

Allowing unregistered "finders" to work outside of this framework would create a regulatory schizophrenia, where individual "finders" could operate unfettered by brokerage regulations, while registered individuals remain subject to the intensive obligations of FINRA rules, inspections, and compliance. These burdens have a high cost, but at present they are evenly applied to all broker-dealers and their registered representatives. The Commission's proposed exemption would create a special class of unregistered individuals without providing similar relief to registered firms and their personnel.

FINRA's focus with respect to private placements and other exempt offerings is to protect investors, and many of the organization's rules are designed to provide far-reaching protections especially to "retail" investors, a term which FINRA defines to be all investors that are not institutional investors.[2]

FINRA Rule 2111 affords safeguards to retail investors who receive a recommendation from a registered broker by imposing regulatory obligations on the broker-dealer to conduct due diligence and establish customer-specific suitability of an investment for each retail investor. Regulation Best Interest has significantly expanded these protections by requiring any recommendation made by a registered representative to be in the "best interest" of a retail investor.

FINRA Rule 2210 creates a strict framework for retail securities advertising, including advertising related to exempt offerings, and Regulatory Notice 20-21 has broadly expanded the application of this rule to both marketing material *and offering documents prepared by an issuer.*

There is no obvious way for a registered broker-dealer or a registered representative to opt out of these regulations by limiting the scope of their involvement in a private offering. While the unregistered "finders" in the Commission's proposed exemption are not permitted to make a recommendation, a registered representative who offers private securities to a retail investor may be presumed to be making a recommendation with every sale. Both the Commission and FINRA have defined "recommendation" in broad terms, so that *any call to action* would potentially be judged to be a recommendation. This is consistent with the Staffs' historical application of the suitability rule to retail investors in private placements, whether or not a recommendation is actually being made by a registered representative.

In short, <u>there is no way</u> for a regulated entity or individual to engage in the limited activity of an exempt, Tier 2 "finder" without incurring a massive, disproportionate, and unfair regulatory burden.

---

[2] FINRA defines "Institutional account" to mean the account of a bank, savings and loan association, insurance company, registered investment company, registered investment adviser or any other person (whether a natural person, corporation, partnership, trust or otherwise) with total assets of at least $50 million.

Consider the following scenarios.

(1) Jerry, the registered representative.

Jerry, a registered representative at BrokerCo, a registered broker-dealer and member of FINRA and SIPC, introduces his friend Bill, an accredited investor with $10 million of investable assets, to NewCo, an early stage private company that is seeking $1mm of seed stage capital. Bill conducts his own review of the company and makes a $250,000 investment. BrokerCo receives a $10,000 placement fee from NewCo, and Jerry receives an $8,000 commission from BrokerCo.

Since NewCo has retained BrokerCo as its placement agent, BrokerCo must conduct reasonable basis due diligence on NewCo, including background checks of its owners and principals, reviewing offering materials for material misstatements or material omissions, etc. If there is a contingency associated with the offering and BrokerCo plans to receive customer funds, it must establish a subscription escrow account in compliance with SEA 15c2-4 and ensure that funds flow in accordance with all applicable regulations. If there is advertising produced by NewCo, BrokerCo must review it to ensure that it is free of material misstatements, since any NewCo liability is likely to end up as BrokerCo's, as well.

Jerry must conduct a suitability review of Bill, disclose all of the firm's and Jerry's own conflicts of interest, and ensure that a $250,000 investment would be in Bill's best interest. He also receives only a portion of the placement fee for making the introduction to Bill; BrokerCo retains a portion of the fee for its work and risk. If the investment ultimately loses money, BrokerCo and Jerry are at increased risk of an arbitration claim from Bill, which would then most likely trigger a regulatory exam of the transaction focused on BrokerCo's due diligence process.

If NewCo hires Jerry directly, he could find himself in deep weeds. Jerry will have engaged in "selling away"[3] if BrokerCo did not approve the deal, and he could be fined or subject to a license suspension or revocation. At many firms, selling away is grounds for termination of employment, which kicks off an automatic regulatory inquiry into the "reason for discharge" reported on Form U5. If a regulatory violation occurred, Jerry might be unemployable, his career ended for the rule violation. If Jerry obtained prior approval, BrokerCo must maintain a complete set of records related to the transaction, since Jerry was compensated in the deal. If the investment loses money, BrokerCo will likely be named in any arbitration, even though it was not involved, since the plaintiff's counsel will claim that the firm knew or should have known about the risk of the investment. The minimum cost to defend even a frivolous claim can be more than $50,000.[4]

(2) Paul, the finder.

[3] FINRA Rule 3280

[4] FINRA member firms must pay FINRA an arbitration filing fee, plus legal costs to prepare a response.

Under the Commission's proposed exemption for Tier II finders, Paul is a "finder" who introduces his friend Jack, an accredited investor with $1mm of investable assets[5], to NewCo. Paul has no formal training in finance, but he knows how to sell and how to close a deal[6]. Paul discusses the investment with Jack, distributes offering materials to him, and participates in several meetings with Jack and the principals of NewCo. Paul uses Snapchat to tell Jack that he thinks the investment could become a "ten bagger."[7] Jack needs big returns to make up for some past investment mistakes, so he decides to invest $250,000. Paul is paid a $10,000 fee by NewCo.

Paul has no regulatory overhead. He has no due diligence obligation with regard to the issuer, the offering, or the investor, and no Regulation Best Interest obligation. His communication with clients is not archived or reviewed for regulatory compliance, and he frequently uses Snapchat to message prospects, since his messages are automatically deleted after they have been viewed by the recipient.[8]

Paul knows that he is not permitted to make recommendations, and he considers himself to be a matchmaker. He reasons that Jack is a "big boy," and this investment is only 25% of Jack's investment portfolio.[9] Jack needs to make up for some past losses, and this could be the ticket. Paul does not provide for arbitration in his "finder" contracts, since it is more difficult and costly for a disgruntled investor to file a lawsuit than to initiate an arbitration claim. He wants to deter any such potential claims. Besides, Paul can point to his limited role and redirect any serious complaints to the issuer.

Conclusion

The foregoing cases are fictional but not far-fetched. If the Commission approves the "finder" exemption, we'll soon be hearing similar stories or worse. Investors will be harmed.

Nobody chooses the path of greater regulation voluntarily. If an individual can conduct private placement business without registration and with no regulatory oversight, they will. In a world where unregistered "finders" can operate with impunity, regulated firms and their registered representatives will suffer. Some will close their doors permanently.

---

[5] Jack is a barely accredited investor, based on investment assets.

[6] The Commission's proposed exemption requires no formal training or registration for "finders."

[7] Paul implies that the investment will return 10x Jack's initial investment. The recommendation is implied, not stated, and Paul's communications are not subject to surveillance or to retention requirements of SEA Rule 17a-4.

[8] Paul understand that his communications could be embarrassing to him if publicly disclosed. He utilizes Snapchat so there is no permanent record.

[9] A 25% allocation to any one investment, especially a high risk, speculative investment in a start-up company, is presumptively not suitable. Jack also exhibits behavioral biases that indicate this investment may not suitable for him.

We urge the Commission to reject the proposed “finder” exemption from broker registration.

Should the Commission proceed with the exemption, we respectfully request that you take steps to level the playing field by promulgating a regulatory safe harbor for “agency brokerage,” to allow registered broker-dealers and their associated persons to refer and offer private placements and other exempt securities without the risk of being deemed to have made a recommendation.

Thank you for your consideration.

James P. Dowd
Chief Executive Officer