The Commonwealth of Massachusetts
Secretary of the Commonwealth
State House, Boston, Massachusetts 02133

William Francis Galvin
Secretary of the Commonwealth

November 12, 2020

VIA ELECTRONIC SUBMISSION: RULE-COMMENTS@SEC.GOV

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

Re: Proposed Exemptive Order Granting Conditional Exemption from the Broker Registration Requirements of the Securities Exchange Act
Release No. 34-90112; File Number S7-13-20

Dear Ms. Countryman:

I write in my capacity as the chief securities regulator for Massachusetts. The Office of the Secretary of the Commonwealth administers and enforces the Massachusetts Uniform Securities Act, M.G.L. c.110A (the "Act"), through the Massachusetts Securities Division. My Office also administers the Massachusetts corporation laws and other business chartering laws. We welcome this opportunity to comment on the Securities and Exchange Commission's Proposed Exemptive Order Granting Conditional Exemption from the Broker Registration Requirements of the Securities Exchange Act (the "SEC" or the "Commission") (the "Proposed Exemption").

The Proposed Exemption would compensate unregistered selling persons and subject them to conflicts of interest. While some may argue that finders are different from broker-dealers or agents of brokerage firms based on claims that they are not in the business of effecting transactions in securities, both the nature of their activities and sound policy under the securities laws call for them to be registered.

Tier 1 Finders

The exemption for Tier 1 finders under the Proposed Exemption essentially codifies the relief provided by the Commission in the Paul Anka no-action letter.[1] While the Paul Anka letter was issued based on a very narrow range of activities and untypical facts,[2] we have encountered finders who have recommended, offered, and sold securities and claimed that such activities were covered under that letter. We urge the Commission to isolate or revoke the Paul Anka letter rather than codifying it. Because the Paul Anka letter allows for unregistered persons to receive transaction-based compensation from the sale of securities, which is a hallmark of broker-dealer status, it undermines the registration system for broker-dealers and agents.

Tier 2 Finders

The exemption for Tier 2 finders establishes a dangerous rule that blesses unlicensed activity by a large category of compensated securities selling persons. Tier 2 finders will have the same kinds of conflicts as broker-dealers, but they will be subject to few rules and no reporting or regulatory system. Based on these factors, the Tier 2 exemption is a recipe for great harm to investors and the issuers that hire finders.

The Proposed Exemption touches on chronic sources of misconduct and fraud in the securities markets. The problems that the states and the SEC have seen relating to finders show the need for strong rulemaking that will bring sunlight to this shadowy area of the markets. We oppose the Proposed Exemption because it would effectively deregulate problematic sales activity in a high-risk segment of the market. We urge the Commission to withdraw the Proposed Exemption and to replace it with a rulemaking that effectively addresses the problems and harm that finders have caused as well as the vulnerabilities of individuals who may invest in early-stage companies.

The Proposed Exemption Does Not Require Finders to Operate in a Regulated System

Under the Proposed Exemption, finders will not be regulated. Finders will not be subject to any conduct rules, will not be subject to qualification or examination requirements, and will not hold registrations or licenses that may be revoked, suspended, or conditioned.

Because finders will not be required to make regulatory filings with the SEC or any other national regulator, such as FINRA, they are likely to be invisible to regulators and market observers until problems arise.

It is particularly concerning that finders will not be subject to federal conduct rules of any kind, yet they will be paid to offer and sell the securities of non-reporting companies, which will

[1] Paul Anka, SEC No-Action Letter, 1991 WL 176891 (July 24, 1991) (providing assurance to the musician Paul Anka that the staff would not recommend enforcement action under Section 15(a) provided that Mr. Anka's involvement in the offering was limited to providing the issuer with a list of names and telephone numbers for individuals that he reasonably believed were accredited investors).

[2] Mr. Anka's involvement was exceptionally limited, and while the staff did not object to the finder's receipt of transaction-based compensation under those limited circumstances, the letter makes clear that the staff's determination was based in large part on representations that the finder would not engage in any solicitation or even have contact with potential investors.

often be early-stage businesses. Unlike securities brokers, finders will not be subject to the requirements of SEC Regulation Best Interest, and they will not be subject to even the traditional brokerage industry requirements of high standards of commercial honor, just and equitable principles of trade, and the obligation to make suitable investment recommendations.

The Financial Standards for Individuals to be Accredited Fail to Protect Vulnerable Retail Investors

The availability of the Proposed Exemption hinges on limiting the activity of finders to accredited investors. This use of the accredited investor definition in the proposal raises longstanding concerns that the financial thresholds for individuals to be considered accredited are too low to protect individual investors in the private markets.[3]

The financial thresholds for individuals to be considered accredited were set 38 years ago. The Commission originally adopted the $200,000 annual income threshold in 1982 and added the provision for joint income ($300,000) in 1988. These thresholds have never been adjusted. The Commission also originally adopted the $1 million net worth threshold in 1982 and revised it in 2011 pursuant to the Dodd-Frank Act to exclude the value of a person's primary residence from the calculation. The $1 million threshold has not otherwise been adjusted.

The Proposed Exemption Lacks Mechanisms to Ensure Compliance

The proposed exemption is broad and will cast a long shadow in terms of finder conduct. Because finders will not be in a regulated system, it is likely that there will be many urban legends and rules of thumb as to what finders must do to meet SEC standards and avoid federal enforcement action.

Because broker-dealers and their agents are subject to black-letter regulatory requirements, there is an industry of lawyers and compliance personnel to help them become registered and to maintain their registrations. These professionals are the front line of securities compliance. Such professionals will be absent in the context of investment finders because finders will have little or no incentive to hire them. The result will be a significant compliance gap, which will leave investors at risk.

Also, the experience of the Massachusetts Securities Division is that investment finders operate at the periphery of the securities markets and that they typically do not have a compliance-oriented mindset. In view of this, it is dangerously unrealistic to expect investment finders to closely adhere to the conditions of the Proposed Exemption.

Foreseeable Effects of the Proposed Exemption

The Proposed Exemption will require finders to claim that they qualify for an exemption from the definition of the term broker based on implausible assertions that are contrary to how non-public offerings are actually sold. Such assertions are likely to include:

---

[3] *See* Regulation D Adopting Release: Revision of Certain Exemptions from Registration for Transactions Involving Limited Offers and Sales, Release No. 33-6389 (Mar. 8, 1982) [47 FR 11251].

- That the finder did not provide advice as to the valuation or financial advisability of the investment. In practice, the essence of a sales pitch and recommendation is that the investment is financially advisable and represents a worthwhile opportunity; no finder is going provide a neutral assessment of the investment that he or she is pitching.
- That the finder did not participate in the preparation of sales materials. This may vary from one offering to another, but it is more realistic to expect that the finder will typically indicate what will and will not work in the sales materials.
- That the finder did not perform an independent analysis of the sale. In a typical transaction involving a finder, the finder recommends the offering and is likely to be vouching for the people who put it together.

It is foreseeable that unregistered brokers will try to fight SEC enforcement actions by urging that they were in fact finders, based on after-the-fact claims that they did not use general solicitation to offer and sell securities, did not participate in putting together the advertising and promotion for an offering, and did not perform their own evaluation or analysis.

Examples of the Harm Caused by Investment Finders

The Proposed Exemption mentions in several places that the Proposed Exemption is intended to facilitate small business capital raising. We ask the Commission to recognize the harm that finders have caused to the small businesses they claimed to be helping.

Our concerns about investment finders are not hypothetical. Investigations and enforcement actions by the Massachusetts Securities Division have provided concrete examples of the harm that finders cause to investors and to the businesses they purport to help to raise capital:

Finder Cases:

2014-0103 In the matter of Position Benefits, LLC and Charles N. Nilosek

Consent Order dated September 25, 2015

2015-0039 In the matter of Woodbridge Mortgage Investment Fund, LLC et al.

Consent Order dated May 4, 2015.

These two matters are related. Nilosek and Position Benefits were not registered to sell securities. Nilosek sold Woodbridge promissory notes to his clients. Woodbridge paid substantial compensation to Nilosek and his firm, Position Benefits, in return for selling the Woodbridge promissory notes.

Over a period of two years, Nilosek and the firm received approximately $607,000 from Woodbridge. This compensation was solely for connecting a prospective investor with Woodbridge. Nilosek assisted clients with setting up self-directed IRA accounts at SHP Financial to hold the notes, but clients worked directly with Woodbridge to purchase the security.

Woodbridge was subsequently found to be a Ponzi scheme and the CEO, Robert Shapiro was sentenced to 25 years in prison.

2016-0094 In the matter of Michael Erlich

Consent Order dated August 14, 2017

Erlich was not registered to sell securities. He is a lawyer with offices in Worcester, Massachusetts. Erlich was introduced to Biochemics, Inc. a pharmaceutical startup and subsequently connected his friends with the company. Erlich's friends made an $180,000 investment with Biochemics and Erlich received $9,000 in commission.

On March 25, 2015, the Massachusetts District Court entered a judgment against Biochemics, Inc. enjoining the corporation from violating the antifraud provisions of the federal securities laws and ordering the defendants to pay $17 million.

2018-0084 In the matter of David Blair Nichols and Frontier Advisors Group, Inc.

Complaint filed on February 6, 2020. This case is pending

2019-0058 In the matter of Glenn C. Mueller, Northridge Holdings, LTD, et al.

Complaint filed on June 10, 2020

These cases are related. Nichols was a previously registered broker-dealer agent that acquired a large number of customers while working at SHP Financial. After his registration lapsed, he sold two promissory note products to his clients: Woodbridge and Northridge. Nichols and his firm, Frontier, received commissions from Woodbridge and Northridge for connecting those companies with prospective investors, but customers purchased the promissory notes directly from Woodbridge or Northridge.

Both Woodbridge and Northridge were found to be Ponzi schemes. The federal case against Mueller and the related Northridge entities is ongoing.

2018-0069 In the matter of Ronald J. Leger, Jr. et al.

Complaint filed on February 6, 2020. This matter is ongoing.

Leger was an accountant who sold viatical investments from the issuer, Life Partners, Inc., to his clients. Leger received substantial commissions from the sale of Life Partners securities to Massachusetts residents.

On December 2, 2014, the United States District Court for the Western District of Texas ordered Life Partners to pay $46.9 million in civil penalties and restitution for violation of securities laws.

These cases show that investment finders have been promoters of, or active participants in, large-scale frauds. Based on these demonstrated problems, we urge the Commission not to adopt the Proposed Exemption.

Finally, we believe the 30-day comment period for the Proposed Exemption is far too short in light of the significance of the proposal and the foreseeable impact it will have on retail investors. We also strongly disagree with the Commission's decision to make these fundamental changes by means of an interpretation rather than a full rulemaking. It is simply wrong for the Commission to rush to make such consequential changes without a full and careful public airing of the issues. The public interest would be properly served by a process that includes an adequate public comment period and an economic analysis that weighs the potential advantages and disadvantages of any proposed rule.

Thank you for the opportunity to comment on this important proposal. If you have questions or I can assist in any way, please contact me or Diane Young-Spitzer, Acting Director of the Massachusetts Securities Division, at [redacted].

Sincerely,

William F. Galvin
Secretary of the Commonwealth
Commonwealth of Massachusetts