Cetera FINANCIAL GROUP

Via e-mail: rule-comments@sec.gov

November 12, 2020

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

Re: Release No. 34-90112; File No. S7-13-20
Proposed Exemptive Order - Activities of Finders

Dear Ms. Countryman:

Please allow this to serve as comments of Cetera Financial Group, Inc. ("Cetera") with regard to SEC File No. S7-13-20 and a proposal by the Commission to issue an Exemptive Order (the "Proposed Order") relating to the activities of individuals referred to as "Finders". In particular, the Proposed Order would create an exemption from the broker registration requirements in Section 15(a) of the Securities Exchange Act of 1934 (the "Exchange Act") if specified conditions are met.

Cetera is the corporate parent of a group of a group of broker-dealers and Registered Investment Advisers ("RIAs"), with more than 7,500 affiliated representatives. Our firms collectively serve more than 1 million retail investors, the large majority of whom are individuals, families, and small businesses. Through our representatives, we provide both transaction-based brokerage and fee-based investment advisory services.

Summary of Our Comments

Broker-dealers operate under a well-defined regulatory regime that is designed to support two goals: Facilitation of capital formation and protection of investors. For the most part, the existing framework strikes the appropriate balance between these sometimes-competing objectives. We support efforts to reduce regulatory burdens imposed on the capital formation process. Particularly for smaller companies, the ability to raise investment capital has become progressively more expensive and difficult, and reducing obstacles to that is in the interest of both business enterprises and the economy as a whole. However, we believe that aspects of the Proposed Order go too far in expanding the scope of activities that would be permissible for individuals who are not registered as brokers under the provisions of the Exchange Act. Before proceeding with this initiative, the Commission should engage in further analysis to determine if it strikes the appropriate balance between facilitation of capital formation and investor protection. In that regard, we note the

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comments of Commissioner Allison Herren Lee in her dissent from the Proposed Order.[1] Commissioner Lee has raised important questions about both the substance of the Proposed Order and the fact that it has been promulgated as exemptive relief and therefore not subject to a more comprehensive rulemaking process. The regulated community and the investing public would both be better served by a more robust examination of this issue, including more detailed consideration of the economic benefits and burdens that it would create.

Relevant Aspects of the Proposed Order

The Proposed Order would establish a framework under which certain individuals ("Finders") could participate in offerings of securities without registration as brokers, as might otherwise be required under Section 15(a) of the Exchange Act. It would create two separate categories of Finders. Both would be subject to a set of conditions, including a prohibition on general public solicitation of investors and limiting contacts to Accredited Investors.

The first group of Finders, Tier I, would be permitted to assist issuers by providing them with information regarding potential investors, but would be limited to supplying such information in connection with a single transaction in a 12-month period. Tier I Finders would not be allowed to have substantive contact with investors regarding the issuer or the transaction.

The second group, referred to as Tier II, would be permitted to perform the activities of Tier I Finders, but could also: (i) Identify, screen, and contact potential investors, (ii) distribute offering materials, (iii) discuss issuer information included in offering materials, and (iv) arrange and participate in meetings with the issuer and investors. Tier II Finders would be allowed to participate in an unlimited number of transactions.

With that as background, we offer the following specific comments:

1. **The activities in which Tier II Finders could participate are too expansive and should be reconsidered.**

The conditions proposed for Tier I Finders are appropriate and worthy of implementation with a few changes. However, the scope of permitted activities for Tier II Finders fails to strike the appropriate balance between facilitating capital formation and maintaining investor protection, and go beyond that which should be allowable for individuals who are not subject to any form of ongoing regulatory oversight. In particular, we view two specific provisions as problematic:

- **Participation in meetings.** While a Tier II Finder would not be allowed to make a recommendation to an investor to purchase securities, the Finder's participation in meetings between the issuer and the investor may tend to result in what the investor views as tacit recommendations. We can envision scenarios in which the Finder has an existing personal or professional relationship with a potential investor such that the investor reposes trust and confidence in the Finder's judgment or business acumen. This would be

[1] https://www.sec.gov/news/public-statement/lee-proposed-finders-exemption-202010-07 - October 7, 2020

particularly true if the Finder had previously been affiliated with a broker-dealer and provided advice to the investor with respect to securities transactions in that capacity. If the Finder participates in a meeting with the issuer and the investor, the Finder may be viewed by the investor as endorsing the statements of the issuer even if the Finder does not say anything, and the silence of the Finder may be viewed as equivalent to a recommendation. Broker-dealers and their representatives operate under a clear standard for what constitutes a recommendation and the obligations that attach to it. Finders would operate in a sort of "gray" area in which the contours of a recommendation are not clear, with a resulting risk of confusion for investors.

The Proposed Order includes a requirement that the Finder deliver a disclosure document to the investor, setting forth the terms of the arrangement between the Finder and the issuer, disclosing the fact that the Finder may receive compensation in connection with any investment, and may have conflicts of interest as result of their role in the transaction. These disclosures help mitigate the risks, but do not go far enough to eliminate the possibility of confusion on the part of the investor.

- **Lack of quantitative limits on the annual number of transactions in which a Finder may participate.** A primary point of differentiation between a Finder and a broker is the ongoing nature of their activities, particularly the regularity of their participation in offerings of securities. If the Proposed Order is adopted in its current form, it is reasonable to assume that many individuals will go into the business of acting as Finders and participate in a large number of transactions. Exemption from broker registration has historically been based on one-time or strictly limited participation in securities offerings. The cost and other burdens associated with registration as a broker would rarely be justified if an individual intends to participate in only a single offering, and that may support the concept of a limited exception from broker registration. However, if a Tier II Finder can operate as an ongoing business, the economic justification for permitting activities of this type without registration and regulatory oversight is diminished. For this reason, we endorse what Commissioner Lee refers to as a "broker-dealer lite" category of registration for these individuals. An example of such a regime can be found in the FINRA rules relating to a class of entities known as "Capital Acquisition Brokers" ("CABs").[2] These entities may assist issuers in structuring transactions and act as placement agents for securities offerings that are exempt from registration under the federal securities laws, but may not hold customer funds or securities. CABs are not generally subject to the customer protection and financial responsibility provisions in FINRA and SEC regulations, but they are subject to limited oversight by FINRA that is more tailored to their activities than broker-dealers that conduct trading and hold customer funds and securities.

  In addition, we believe that the likelihood of the "silent" or tacit recommendation described above increases dramatically if the Finder is involved in numerous transactions. It is reasonable to assume that Finders will tend to solicit the same group of investors to participate in offerings in which they are involved. This naturally leads to a greater sense

[2] See FINRA Capital Acquisition Broker Rules - https://www.finra.org/rules-guidance/rulebooks/capital-acquisition-broker-rules

of familiarity and trust in the Finder and an increased likelihood of confusion on the part of the investor.

There is a spectrum of activities on which all individuals involved in locating investors for securities offerings fall. In the materials accompanying the Proposed Order, the Commission has included a chart summarizing these activities. The chart provides a comprehensive list, and presents a useful analytical framework. However, what would be permissible for Tier II Finders, particularly the ability to participate in meetings with issuers and investors, extends beyond the point at which regulatory oversight is necessary. Some form of limited registration and tailored oversight strikes a more appropriate balance between facilitation of capital formation and investor protection. The contours of this oversight, including the economic impact on both Finders and other entities such as broker-dealers, and capital formation, should be the subject of a more formal rulemaking process.

2. Additional Questions Posed

The Commission has also requested comments on a number of specific questions. We offer the following with respect to several of them:

Question No. 2. - Different tiers of Finders. As discussed above, the criteria proposed for Tier I Finders are generally appropriate. The activities that would be allowable for Tier II Finders should be reserved to individuals registered as brokers or under a similar regulatory regime.

Question Nos. 3 and 4. - Limitation to natural persons and U.S. residents. As discussed above in our comments regarding regularity of participation, entities that are formed for the purpose of acting as Finders are far more likely to require regulatory oversight. Finder status should be limited to natural persons. Further, reliance on any Finder exemption should be limited to persons who are resident in the United States. In the event of enforcement or administrative action against a person acting as a Finder, it will be difficult to obtain jurisdiction over non-resident individuals.

Question No. 6. - Limitation to Accredited Investors. Issuers that utilize Finders to locate investors are more likely to be smaller and potentially riskier ventures. Investors who are solicited by Finders do not have most of the protections applicable to customers of registered brokers. At a minimum, there should be some assurance that these investors possess a combination of investment sophistication and financial resources that is sufficient to allow them to understand and bear the risks inherent in any investment. A requirement that solicitations be limited to Accredited Investors is one way to accomplish that.

Question No. 9. - Limits on the number of offerings in which a Finder may participate. Limiting the number of offerings in which a Tier I Finder can participate to one per year is appropriate.

Question No. 10. - Limits on contact with investors. As discussed in our comments above, allowing Finders to have contact with investors with respect to securities offerings materially increases the risk of what the investor may view as tacit investment recommendations by the Finder. Tier I Finders should not be allowed to have any substantive contact with investors regarding the offering.

Question No. 13. - Limitation to exempt offerings. Any Finder exemption should be limited to offerings that are exempt from registration. One of the stated premises for creating a Finder exemption is that it decreases the regulatory hurdles for smaller enterprises trying to raise capital. Registered offerings involve a considerable level of expense and effort for the issuer in any event. If the issuer is prepared to bear the effort of a registered offering, that justification is less applicable. In addition, it is rare for a registered offering to be restricted to Accredited Investors. Use of Finders in connection with registered offerings will tend to increase the likelihood that non-accredited investors will be solicited or referred to the issuer.

Question Nos. 17 - 21. Disclosures – Form, acknowledgement, and timing of delivery. As discussed above, we do not believe that there are sufficient controls on the activities of Tier II Finders, and would not allow them to operate under the conditions set forth in the Proposed Exemption. That being said, if Tier II Finders are permitted to engage in the specified activities, the scope of the disclosures outlined in the Proposed Order are likely sufficient. We suggest the following with respect to the logistics of a disclosure regime:

- All Finders should be required to deliver a written disclosure document to potential investors. Oral disclosures are inherently less precise than written versions, and the time and manner in which they are delivered is difficult to document.

- The disclosure document should be delivered to potential investors at or prior to the time of any substantive discussion about the offering. While the Proposed Order does not contemplate Finders making recommendations, we believe that the potential for tacit recommendations cannot be overstated. The primary purpose of the disclosure document is to alert investors to the possible existence of a conflict of interest on the part of the Finder. It allows the investor to consider the motivation of the Finder in introducing them to the issuer and evaluating the Finder's role in any discussions between the investor and the issuer. In order for this to be useful to the investor, it must be delivered prior to any substantive communication.

- All Finders should be required to obtain a written acknowledgment that the investor has received the disclosure document.

- Delivery by electronic means such as email should be both permitted and encouraged.

Question No. 22. - Issuer liability for misstatements of Finders. Subject to our comments regarding the advisability of allowing Tier II Finder status for anyone, all Tier

II Finders should be required to enter into a written agreement with the issuer in which the issuer assumes liability to investors with respect to misstatements by the Finder in connection with the offering. Given that Finders would not be subject to any form of ongoing regulatory oversight, requiring the issuer to assume responsibility for misstatements of the Finder is an appropriate form of investor protection. It would also create an additional incentive for the issuer to monitor the activities of the Finder.

Question No. 23. - Notice of participation. Tier II Finders and/or issuers should be required to file a notice with the Commission with respect to any offering for which they are relying on the Finder exemption. The limitations of Tier I status are such that notice may not be necessary, but given the possibility that Tier II Finders would be involved in a large number of offerings, notice to the Commission would be useful in identifying trends or patterns of behavior and allow for early warning with respect to potential problems. The information included in such a notice is a proper subject for further rulemaking and analysis, but it should include, at a minimum:

- The number of investors that the Finder contacted in connection this the offering;
- The amount of money invested by investors whom the finder solicited;
- Other offerings sponsored by the issuer or affiliates in which the Finder has participated; and
- Prior status of the Finder as an associated person of a broker-dealer. (Please also see our additional comments in response to Question No. 35, below.)

Question Nos. 25 and 26. Forms of compensation payable to Finders. Payment of transaction-based compensation ("TBC") to Finders creates a number of issues, including conflicts of interest. If the compensation payable to the Finder is dependent upon completion of a transaction, the Finder has a greater incentive to encourage the investor to participate in the offering, or perhaps more likely, not to discourage participation by correcting misimpressions that the investor may have. That being said, if the fact that the Finder will receive TBC is properly disclosed to the investor, it should be permitted for Tier I Finders. Our comments above regarding the role of Tier II Finders and the possibility of tacit recommendations militate in favor of limits on TBC for Tier II. It would also be appropriate to require that any compensation payable to Finders be fixed as a percentage of the amount invested by investors referred by the Finder. A "sliding scale", in which the percentage of compensation payable to the Finder increases in proportion to the gross amount invested in the offering compounds the incentive for the Finder to engage in prohibited activities or to countenance tacit recommendations. For the same reason, Finders should not be able to receive compensation in the form of a financial interest in the issuer in lieu of or in addition to cash payments.

Question No. 29 - Permissible activities for Tier II Finders. As discussed above, allowing Tier II Finders to participate in discussions with the issuer and the investor creates a number of potential problems that are not easily addressed. Any guidance that

the Commission could develop would by its nature be limited to the circumstances of each specific case, including the relationship among the parties, the specificity of the information delivered, and the level of expertise and sophistication of the investor. If guidance is issued, a principal consideration is that the Finder should not be allowed to make any statement regarding the projected operating results or investment returns in connection with the offering. General statements about the business in which the issuer engages or how it intends to invest the proceeds of the offering may be permissible, but projections of revenue, profit, or investment performance should be prohibited.

Question No. 32. - Reliance on prior guidance. If the Commission elects to create new exemptive relief for Finders, it should do so in a comprehensive fashion and withdraw all previous guidance. The staff has issued a large number of no-action letters on this topic, covering a wide range of circumstances. Any new regime should establish a comprehensive framework and eliminate the possibility for conflicts between new and existing guidance.

Question No. 35. - Prohibition of reliance on the Finder exemption by associated persons of broker-dealers. Any exemption for Finders should strictly limit its utilization by individuals who have previously been associated persons of broker-dealers. Without such a restriction, associated persons will have not just the ability, but often a strong incentive to work as representatives of broker-dealers and leave for brief periods to act as Finders with respect to one or more offerings. This increases the likelihood that the Finder will solicit investors with whom he or she has an existing relationship as a financial advisor. The fact that the Finder is no longer acting on behalf of the broker-dealer with which they were previously affiliated may be difficult for the investor to understand, especially if the Finder leaves the broker-dealer, participates in one or more offerings as a Finder, and subsequently reaffiliates with the broker-dealer. Despite the requirement for a disclosure document, the possibility of confusion by investors is dramatically increased. The Commission should also consider a requirement that anyone who acts as a Tier II Finder would be prohibited from becoming an associated person of a broker-dealer for a reasonable period of time after their participation in an offering ends.

Question No. 39. - Potential competitive impact on registered brokers. Allowing individuals to perform activities without oversight that are adjacent to a business that is highly regulated has the potential to create any number of economic issues, including the possibility for Finders to engage in "regulatory arbitrage". A comparison of the activities in which registered brokers may engage and those permitted for Tier II Finders does not show a lot of substantive differences, which reinforces the incentive for individuals who are currently associated with broker-dealers to become Finders as an alternative. We are not aware of research that specifically considers this question, but it may exist or it could be undertaken by an interested party. This is clearly an area in which additional rulemaking and analysis would benefit the Commission and investors prior to implementation of any rules relating to the conduct of Finders.

The costs and other burdens of registration for broker-dealers are considerable, both initially and on an ongoing basis. There would be a considerable economic incentive for

individuals who have traditionally been associated persons of broker-dealers to act as Finders instead. As such individuals migrate away from broker registration to Finder status, there would be a natural tendency for the activities of registered brokers and Finders to converge. This creates a greater probability of confusion for investors and Finders "pushing the envelope" on the scope of their activities. This issue should be more fully explored.

Question No. 40. - Implications of requiring Finders to register as brokers. As discussed above, the conditions prescribed for Tier I Finders are such that requiring them to register as brokers would not materially add to investor protection. Tier I Finders can only participate in a limited number of offerings and their involvement in any discussions between the issuer and investor would be limited. They do not create a pressing need for broker-dealer registration. On the other hand, the formulation proposed for Tier II Finders, including regular and ongoing participation in offerings and significant contact with investors is such that some form of regulatory oversight is necessary. The FINRA model for Capital Acquisition Brokers provides a useful starting point. In addition to customer protection and regulatory oversight, there are significant economic ramifications to requiring broker-dealer regulation. This is an area in which the Commission should engage in further analysis and rulemaking to determine the extent of those effects and the possible approaches.

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We appreciate the opportunity to submit comments in connection with this matter. If you have questions or we may provide any further information, please let me know.

Yours truly,

Mark Quinn
Director of Regulatory Affairs