



NASAA

NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.

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November 13, 2020

Hon. Jay Clayton, Chairman
Hon. Hester M. Peirce, Commissioner
Hon. Elad L. Roisman, Commissioner
Hon. Allison Herren Lee, Commissioner
Hon. Caroline A. Crenshaw, Commissioner
United States Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

By email to chairmanoffice@sec.gov, [REDACTED], and
[REDACTED], and
[REDACTED]

Dear Chairman Clayton and Commissioners Peirce, Roisman, Lee, and Crenshaw:

We, the undersigned state authorities, write to voice our collective concern regarding the Commission's recent proposal to order a new broker-dealer exemption for private placement finders as part of a larger exemptive framework that the Commission is advancing following its Harmonization Concept Release last year. Individually, we represent states spanning the entire geographical and political landscape of the United States. While we each have unique constituencies and challenges facing our distinct sovereign interests, we stand united and firm in our core mission of investor protection.

As it stands now, the private placement market is a very risky place for Main Street investors. The private markets are vast and, by design, opaque with little to no publicly validated data on individual private companies. Because there is currently no federal or state review process for deals offered in this market, the private markets frequently draw unscrupulous actors.¹ As such, unregistered securities have taken a perennial spot on NASAA's annual list of concerns.

Just last month, NASAA released its 2020 Enforcement Report (based on 2019 data), where unregistered securities once again topped the list.² With respect to elder fraud and exploitation in particular, unregistered securities represented a staggering 71% of state actions reported. In these

¹ See, e.g., Commission Office of the Inspector General, Report No. 459, *Regulation D Exemption Process* (Mar. 31, 2009), available at <http://www.sec-oig.gov/Reports/AuditsInspections/2009/459.pdf>.

² See NASAA 2020 Enforcement Report, available at <https://www.nasaa.org/wp-content/uploads/2020/09/2020-Enforcement-Report-Based-on-2019-Data-FINAL.pdf>.

cases, unregistered securities appeared more frequently than all other product types and sales tactics combined.

A common thread in many of these state unregistered securities cases is the presence of an unlicensed intermediary. States reported 738 actions against unregistered actors in 2019, an increase of 15% from the previous year. Many of the worst criminal securities fraud cases arise from the combination of unregistered securities offerings promoted and sold by unlicensed intermediaries. The massive Woodbridge fraud is but one recent, compelling example.³

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.⁴ 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.⁵ 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.

Given both perennial concerns about and recent incidents of extraordinarily harmful frauds perpetuated by persons acting as finders, the last thing state securities regulators expected to see was a Commission proposal that facilitates unlicensed intermediaries in the private market. State authorities are even more troubled by the broad scope of the proposed exemption, which extends far beyond traditional finder activities into core broker criteria, including direct solicitation and transaction-based compensation. Even industry proponents of regulatory clarity for finders have recognized the need for caps on the number of deals, limits on compensation, and certain

³ Other recent prominent examples include *In re Wisconsin Home Buyers Network.*, DFI File No. S-236789 (EX), Wisconsin Dept. of Financial Institutions (Oct. 14, 2020), available at http://wdfi.org/resources/indexed/site/newsroom/admin_orders/2020/236789%20Wisconsin%20Home%20Buyers%20Network.%20LLC.%20etc.%20Final%20Order.pdf; *Virginia v. Edward Carr*, Case No. SEC-2016-00022, Va. Corp. Comm. (Mar. 23, 2020), available at <https://scc.virginia.gov/docketsearch/DOCS/4lzg01!.PDF>.

⁴ *Florida real estate schemer pleads guilty to \$1.3 billion fraud. Most victims were retirees.* Miami Herald (Aug. 7, 2019), available at <https://www.miamiherald.com/news/local/article233611332.html>.

⁵ *SEC Charges Three Woodbridge Sales Agents Who Sold and Assisted in Selling Approximately \$444 Million in Woodbridge Securities to Retail Investors*, Lit. Rel. No. 24759 (Mar. 5, 2020), available at <https://www.sec.gov/litigation/litreleases/2020/lr24759.htm>; *Securities and Exchange Commission v. Brook Church-Koegel, et al.*, Case No. 1:20-cv-21001 (S.D. Fla. Mar. 5, 2020), available at <https://www.sec.gov/litigation/complaints/2020/comp24759.pdf>.

recordkeeping and supervisory requirements, as well as other regulatory safeguards absent from the proposal.⁶

We should note (as NASAA has in numerous comment letters over the years) that limiting an exemption to sales made to accredited investors is not meaningful protection for investors because financial thresholds have not been updated in nearly 40 years. Indeed, the Commission need look no further than the Woodbridge case – in which many accredited investors, such as retired doctors and school teachers, lost everything – to know that this proposal runs directly counter to the public interest and, if ordered, will actually harm rather than protect investors.

Given the explanations described in the proposing release, it is clear that the proposal is not driven by investor protection considerations, but by a purported desire to help small businesses obtain capital. Although that is a worthy goal we all share, small business issuers will not benefit from a federal exemption in the absence of a coordinated state finder registration framework. To be successful, we must work together to develop a balanced and coordinated framework that serves both issuers and investors in the private market. The Commission should also be mindful that the current proposed exemption, which would bar finders from engaging in any due diligence activities, could ironically be harmful to capital formation because finders would be drawn to issuers based solely on the amount of compensation offered for their services. As a result, the proposed exemption threatens to drive finders to both fraudulent and lackluster issuers, which would thereby undermine the proper allocation of capital. While there are a few scaled registrations frameworks available at the state level, there is insufficient time within a thirty-day comment period to fully review and reflect on them. Nevertheless, the Commission should appreciate that state efforts are a measured approach to creating flexibility and regulatory certainty for the activities of finders while at the same time ensuring that their efforts are not free from oversight. An exemptive framework of this controversial nature and magnitude – particularly in the context of our opaque and risky private markets – deserves a full public rulemaking effort.

⁶ See U.S. Department of Treasury, *A Financial System that Creates Economic Opportunities: Capital Markets* (Oct. 2017) at 43-44, available at <https://home.treasury.gov/system/files/136/A-Financial-System-Capital-Markets-FINAL-FINAL.pdf> (proposing that an “appropriate regulatory structure” should be provided for finders that could include a “broker-dealer lite” type of registration); SEC Advisory Committee on Small and Emerging Companies, Letter to Mary Jo White, Chair, SEC (Sept. 23, 2015) at 4, available at <https://www.sec.gov/info/smallbus/acsec/acsec-recommendations-regulation-of-finders.pdf> (recommending that the Commission engage in a joint effort with NASAA and FINRA “to ensure coordinated State regulation and adoption of measured regulation that is transparent, responsive to the needs of small businesses for capital, proportional to the risks to which investors in such offerings are exposed, and capable of early implementation and ongoing enforcement”); American Bar Association, *Report and Recommendations of the Task Force on Private Placement Broker Dealers* (June 20, 2005) at 48, available at <https://www.sec.gov/info/smallbus/2009gbforum/abareport062005.pdf> (noting that caps on the number of investors or dollar amounts available were among the points of discussion for an exemption, while also expressing concern that an exemption “would be likely to exacerbate the situation by permitting [unscrupulous] parties to hide behind the available exemption,” and also noting that “[i]n contrast, a registration system would permit parties to determine whether the individuals they are contracting with to provide finder services are in compliance with applicable registration requirements”).

NASAA will submit additional, more detailed comments regarding the finder proposal. However, we respectfully request that the Commission defer action on the proposal until the Commission has met with the states regarding the purported need for and propriety of a private placement finder exemption. Moreover, given the rapid pace with which these exemptive proposals are currently being released by the Commission⁷ and the significant ramifications that each directly poses to investors in our jurisdictions, please consider this a standing request for such meetings by NASAA and the states for any and all future proposals emanating from the Harmonization Concept Release or otherwise removing investor protections in the risky private markets.

There is no doubt in our minds that the Commission and the states, standing together, will be much more effective in protecting our citizens and making the private markets successful for small businesses than we could ever hope to be standing apart. If you have any questions regarding this letter, please contact any of the signatories below. Thank you for your consideration.

Sincerely,



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Director
Alabama Securities Commission

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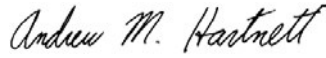
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Alex Glass
Securities Commissioner
Indiana Office of the Secretary of State, Securities
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⁷ For instance, the Open Meeting to consider adoption of the proposal on the harmonization of offering exemptions is being held on November 2, 2020. See Sunshine Act Meeting Notice (Oct. 26, 2020), available at <https://www.sec.gov/news/openmeetings/2020/ssamtg110220.htm>. This would be the second private markets rulemaking this year, following the adoption of amendments to the accredited investor definition. See SEC Rel. No. 33-10824 (Aug. 26, 2020), available at <https://www.sec.gov/rules/final/2020/33-10824.pdf>.



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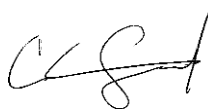
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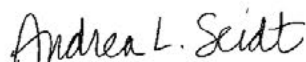
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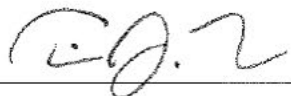
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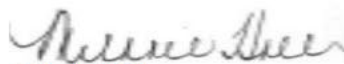
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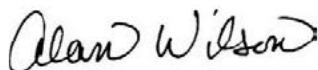
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Chairman Clayton and Commissioners Peirce, Roisman, Lee, and Crenshaw

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