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November 12, 2020

Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
By Email: (rule-comments@sec.gov)

Re: File Number S7-13-20, *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*

Dear Ms. Countryman:

CFA Institute[1] appreciates the opportunity to respond to the U.S. Securities and Exchange Commission (the "SEC" or the "Commission") on its 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 ("Proposal" or "Release").[2]

CFA Institute speaks on behalf of its members and advocates for investor protection and market integrity before standard setters, regulatory authorities, and legislative bodies worldwide. We focus on issues affecting the profession of financial analysis and investment management, education and competencies for investment professionals, and on issues of fairness, transparency, and accountability of global financial markets.

Executive Summary

Investor protection and market transparency should be paramount in any review of the application of regulations to financial intermediaries known as finders.[3] Unfortunately, the proposal would apply an

[1] CFA Institute is a global, not-for-profit professional association with more than 80,000 U.S.- based investment analysts, advisers, portfolio managers, and other investment professionals affiliated with our 67 CFA local societies in the United States. Globally, our membership includes more than 185,400 investment analysts, advisers, portfolio managers, and other investment professionals in 163 countries, of whom more than 178,500 hold the Chartered Financial Analyst® (CFA®) designation. CFA Institute membership also includes 160 member societies in 77 countries and territories.

[2] SEC, Release No. 34-90112; File No. S7-13-20, *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*, ("Proposed Order"), (Oct. 7, 2020), at https://www.sec.gov/rules/exorders/2020/34-90112.pdf.

[3] The proposal describes finders as persons who "may identify and in certain circumstances solicit potential investors, [and] often play an important and discrete role in bridging the gap between small businesses that need capital and investors who are interested in supporting emerging enterprises." *See* Proposed Order, *supra* note 2, at 5.

overly broad exemption that would remove essential elements of investor protection and transparency from the solicitation activities of finders. Therefore, we cannot support it.

The proposal would divide finders into two classes, Tiers I and II, each to be defined by a set of conditions specifying permitted and prohibited activities.[4] Our objections center on the proposed exemption for Tier II Finders, who would be allowed to engage in a wide range of solicitation activities on behalf of private issuers.[5] Tier II Finders would be permitted personally to contact accredited investors,[6] arrange sales meetings of these potential investors with issuers, and attend those meetings. These activities clearly fit within the definition of a broker.[7] Moreover, Tier II Finders would be allowed to receive transaction-based pay,[8] which gives rise to conflicts of interests.[9]

Notwithstanding the scope of these solicitation activities, the proposal would exempt Tier II Finders from the requirement to register[10] and the web of broker rules that flow from registration. The proposed exemption would also place finders outside the purview of SEC and FINRA compliance inspections.[11] And without such exams, it is difficult to see how SEC or FINRA could maintain effective enforcement against finders for violations of our federal securities laws and regulations – including failure to comply with the conditions that finders would be required to meet to rely on the proposed exemption.

To address such conflicts of interest and other investor protection concerns, the proposal sets out a number of conditions for finders to benefit from the exemption.[12] We believe these conditions are no substitute for the comprehensive investor protections afforded by the full set of broker rules.

The release describes the proposal as narrowly tailored.[13] We view it, on the contrary, as overly broad. A tailored regulation would address specific challenges that finders are said to face, while retaining investor protection rules. For example, some commentators have argued that certain capitalization and financial reporting obligations imposed on broker-dealers should not apply to finders who do not hold customer

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[4] *See id*. at 22-24. For an overview chart that illustrates key permissible activities of Tier I and Tier II Finders, see SEC Office of the Advocate for Small Business Capital Formation, Finders Proposed Exemptive Order: Overview Chart of Tier I Finders, Tier II Finders and Registered Brokers, available at https://www.sec.gov/files/overview-chart-of-finders.pdf.

[5] We do not have the same objections to the proposed safe harbor for Tier I Finders, because they would be prohibited from having any contact with potential investors about the issuer and would 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. *See* Proposed Order, *supra* note 2, at 22-23.

[6] Finders would be prohibited from engaging in general solicitation, but could contact persons with whom they or the issuer had a substantive preexisting relationship. *See* id., at 18 and 20.

[7] *See* id., at 11 ("Section 3(a)(4) of the Exchange Act generally defines a 'broker' as 'any person engaged in the business of effecting transactions in securities for the account of others.'") The statutory definition is not limited to accounts of non-accredited investors.

[8] *See* id., at 27.

[9] See our discussion *infra* at 6.

[10] *See* Proposed Order, *supra* note 2, at 17.

[11] See, e.g., Commissioner Carolyn Crenshaw, Statement on Proposed Exemptive Relief for Finders, (Oct. 7, 2020) ("Moving forward, Finders would not be subject to periodic inspections or examinations, nor would they be required to maintain records of their activities.").

[12] *See* Proposed Order, *supra* note 2, at 27 ("The Commission preliminarily believes that the proposed exemption is narrowly drawn to permit a limited set of activities, subject to conditions intended to address investor protection concerns…"). We discuss these conditions *infra* at 6-8.

[13] *See* Proposed Order, *supra* note 2, at 18.

funds or securities.[14] We believe it would be reasonable to consider such an approach, focusing on alleviating individual regulatory burdens while retaining regulations and practices that protect investors, including registration, record-keeping requirements, sales practice rules—including Regulation Best Interest ("Reg BI")—and compliance exams. This proposal, however, takes a different path. Rather than fine-tuning the regulations to the needs and characteristics of finders, it would exempt them from the regulations.

Finally, we believe that a rule proposal would be more appropriate than the proposed exemptive order in light of its scope. A rule proposal would include an economic analysis, including examination of the competitive impact of this proposal on small brokers.

Investor Protection Considerations

The introduction to the release begins, "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." Absent is any affirmation of the Commission's mission to protect investors. It stands in sharp contrast with the sec.gov homepage which displays a rotating banner proclaiming in all caps, "WE ARE THE INVESTOR'S ADVOCATE." Unfortunately, the sentence suggests an imbalance in priorities we believe permeates this proposal. It places excessive weight on the goal of facilitating transactions in private markets, and does so at the expense of investor protection and market transparency.

The background section of the release emphasizes the constructive role that finders play in helping entrepreneurs and small businesses find capital. We would agree that most finders fit this description. Unfortunately, however, the full picture also includes a "dark side,"[15] in which the worst of finders comprise fraudsters, pump-and-dump market manipulators, and con artists, many of whom ply their schemes in the shadows of the less regulated private markets. Observers and finders' advocates have been quite candid in acknowledging and depicting this underworld of bad actors.

For example, the SEC Small Business Capital Formation Advisory Committee highlighted problems of fraud and other illegal activities in its discussion of the proposed exemptive order on Nov. 9, 2020.[16]

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[14] *See, e.g.*, Gregory C. Yadley, "Notable by Their Absence: Finders and Other Financial Intermediaries in Small Business Capital Formation," (June 2015), available at https://www.sec.gov/info/smallbus/acsec/finders-and-other-financial-intermediaries-yadley.pdf, ("Yadley") at 7 ("The point would be to bring these PPBs [private placement brokers] under the tent but not impose such stringent regulations as would make it financially untenable for them to register. The Task Force believes that PPBs should be required to register with the SEC and the state regulators, pass an examination and keep certain records. However, they should not, for example, be required to maintain minimum net capital or submit traditional financial reports or audited financial statements or have to maintain substantially all of the compliance infrastructure required of a full-service brokerage firm."). *See also* Faith Colish, Bloomberg Law, "Insight: Finders and Private Placement Brokers: The Missing Link and H.R. 6127," (Nov. 14, 2018) ("Colish Article"), (noting the "burdens" of the Net Capital Rule as well as the obligations to file financial ''FOCUS'' reports and annual audited financial statements).

[15] *See* Yadley *supra* note 14, at 4 ("Unfortunately, in many other cases, persons acting as finders represent "the dark side" of the securities business: purveyors of fraudulent shell corporations; front-end fee con artists; purported Regulation S specialists who send stock off-shore and wait to dump it back into the U.S. through unscrupulous brokerage firms or representatives who are receiving under-the table payments for promoting stocks and micro-cap manipulators.").

[16] Melanie Senter Lubin, Maryland Securities Commissioner, stated, "In 2019, states took 738 enforcement actions against unregistered persons including 57 against unregistered finders and solicitors, more than doubling the number

An ABA Task Force that studied the issue stated in its report:

> At their worst, unregistered financial intermediaries are the bane of the financing business...They can be making offerings that violate the antifraud provisions of the federal and state securities laws. They can be the purveyors of that most worthless product in the securities industry - the "clean public shell." They can bring to the transaction the market manipulators and profiteers whose only interest is the fast buck regardless of the consequences to the company or its investors. They can cause offers or sales to occur without regard to compliance with the very requirements of the securities offering exemptions they purport to rely on when advising an issuer.[17]

Even as the Release cites these sources as proponents of reduced regulation for finders,[18] it stays silent on this dark side. The underworld of wrongdoing makes the need for strong investor protections all the more urgent. Unfortunately, however, the proposed exemption not only fails to address these problematic practices, but would likely exacerbate them.[19]

The proposed exemption would limit the work of finders to private markets. That further magnifies investor protection concerns, because private markets lack the transparency and investor protections of public markets.[20] Private markets also present heightened risks of fraud, as front-line state securities regulators have long warned.[21]

Sunshine and transparency are the most effective means to address these investor protection concerns, and that begins with the requirement to register as brokers. Registration serves a critical screening function.

Exemption from broker regulation, in contrast, would place finders in the regulatory shadows, outside of the sunshine of registration, outside the set of broker rules that flow from registration, and outside the watch of SEC and FINRA compliance exams. This would only exacerbate investor protection problems. That is precisely what the ABA Task Force Report has warned against:

> In addition, an exemption would not address the current concern regarding the number of unscrupulous parties that are engaged in these activities. Indeed, creating an exemption would be likely to exacerbate the situation by permitting these parties to hide behind the available exemption. In contrast, a registration system would permit parties to determine whether the

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since 2015." Another committee member, Sara Hanks, while generally supporting the proposed order, warned of widespread violations of broker rules. She recommended that the Commission step up its activities. *See* Public Meeting of the SEC Small Business Capital Formation Advisory Committee, Nov. 9, 2020.

[17] Report and Recommendations of the American Bar Association Business Law Section Task Force on Private Placement Broker-Dealers ("ABA Task Force Report") (June 2005), *available at* https://www.sec.gov/info/smallbus/2009gbforum/abareport062005.pdf, at 7.

[18] *See* Proposed Order, *supra* note 2, at 4-7.

[19] See our discussion *infra* at 4.

[20] We have raised this concern in previous comment letters. *See, e.g.*, James C. Allen, CFA Institute Comment Letter on Amending the "Accredited Investor" Definition (May 4, 2020) ("CFA Institute Letter").

[21] *See, e.g.*, NASAA Letter to the House Committee on Financial Services Re: H.R. 6127, the "Unlocking Capital for Small Businesses Act of 2018," (November 19, 2018), ("Moreover, there is a well-documented relationship between private offerings sold by brokers and an elevated risk of fraud."). *See also* California State Attorney General Xavier Becerra et al, Comment Letter on Concept Release on Harmonization of Securities Offering Exemptions, Release No. 33-10649, File No. S7-08-19, (September 24, 2019), ("[T]he limited data that is available suggests that purported exempt offerings are often associated with fraud.").

individuals they are contracting with to provide finder services are in compliance with applicable registration requirements.[22]

The Benefits of Registration

We note that the Commission, in its longstanding public outreach and education activities, has embraced this distinction between registered and unregistered investment professionals. The SEC's Office of Investor Education and Advocacy, for example, has engaged in vigorous investor education campaigns for retail investors to "Check Out Your INVESTMENT PROFESSIONAL."[23] The SEC's website for individual investors, investor.gov, admonishes retail investors, "Never invest your money with someone who is not licensed and registered."[24]

By exempting finders from mandatory broker registration, the proposal would muddy what until now has been consistent messaging in the Commission's educational efforts. Importantly, the proposed exemption may confuse investors as to the duties and obligations of various persons—brokers, investment advisers, or finders—who may seek to advise them or solicit their investments. We urge the Commission to pay particular attention to the risks of investor confusion, the more so since the proposal is predicated on a purported need to provide clarity to what is described as a gray market.[25]

We recognize that the mere fact of registration, in itself, will not ensure against fraud or other problematic practices that harm investors. Nonetheless, registration constitutes an important tool that helps regulators protect investors and helps investors to protect themselves.

Registration not only brings finders into the sunlight of market transparency and provides a screening function; registration invokes a comprehensive set of broker rules and regulations governing record-keeping, sales practices, and other aspects of broker conduct.[26] Regulation Best Interest, which occupies a preeminent place among the sales practice rules, requires that brokers not place their own interests ahead of retail investors.[27] The broker rule set provides critical investor protections, not only in combatting the exceptional cases of fraudsters and other wrongdoers, but also in governing the conduct of the mainstream brokers who are honest and ethical.

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[22] *See* ABA Task Force Report, *supra* note 17, at 48 and at 2 [recommending that any regulatory solution provide "a means of distinguishing the good (the honest, ethical and licensed) from the bad (the charlatans and dishonest, unethical brokers who cannot be licensed, or refuse to become licensed even though the regulations are redesigned to fit the activities)."].

[23] Capitalization in the original. Investor.gov homepage (last checked Nov. 9, 2020).

[24] *See* https://www.investor.gov/protect-your-investments (last checked Nov. 9, 2020). We recognize the distinction between finders, who would solicit on behalf of issuer and receive compensation from them; investment advisers, who would advise investor clients and receive compensation from them; and brokers, who would receive transaction-based compensation for executing transactions. But these distinctions may be lost on many retail investors, including a number of accredited investors.

[25] *See* Proposed Order, *supra* note 2, at 6 and 10 ("The Commission preliminarily believes that this exemption would provide clarity to investors and issuers…").

[26] *See id.*, at 10 ("Registered broker-dealers are subject to comprehensive regulation under the Exchange Act and under the rules of each self-regulatory organization ("SRO") of which the broker-dealer is a member, including a number of obligations that attach when a broker-dealer makes recommendations to a customer, as well as general and specific requirements aimed at addressing certain conflicts of interest.").

[27] Regulation Best Interest: The Broker-Dealer Standard of Conduct, Exchange Act Release No. 34-86031 (June 5, 2019) ("Regulation Best Interest Adopting Release") at 17.

The proposal would exempt finders from all of these rules. In addition, the proposal would deprive the SEC and FINRA of the ability to conduct compliance inspections and exams of finders, as we discuss further below.

Finders' Conflicts of Interest

The rules addressing finders' conflicts of interest deserve special attention. All finders, no matter how honest or ethical, face conflicts of interest when they receive transaction-based pay; i.e., payment contingent on the sale of private securities in which the finder solicits offerees to invest. That incentive structure presents finders with a conflict between their own economic interests and their level of candor in presenting the investment proposition to the potential investors whom they contact.[28] As a result, transaction-based compensation has traditionally been considered a key indicator that generally requires broker registration and its related set of broker rules.[29]

The proposal would expressly permit Tier II Finders to receive transaction-based pay and, in addition, to engage in a wide set of solicitation activities:

(i) identifying, screening, and contacting potential investors;

(ii) distributing issuer offering materials to investors;

(iii) discussing issuer information included in any offering materials, and

(iv) arranging or participating in meetings with the issuer and investor.[30]

Taken together, these activities constitute solicitation of investors on behalf of issuers. They give ample scope for conflicts of interest to emerge. The Proposal purports to address these potential conflicts by making the proposed exemption contingent on several conditions. The Release suggests that these conditions obviate the need for finders to register and become subject to the broker regulatory framework.[31]

We disagree.

A few individual restrictions cannot replace the full force of the system of broker rules and regulations. Moreover, the proposed exemptions from compliance exams would deprive the Commission and FINRA of the ability to determine whether finders are abiding by the conditions of the proposed safe harbor. And even if finders fully comply with those conditions, the Commission will be unable to assess whether those conditions provide adequate investor protections or, on the contrary, whether further protections are needed. Without exams, any unexpected consequences of the proposed exemptive order might go undetected and or unassessed until investors have incurred losses and filed for legal recourse. Nor would

[28] See Colish Article, *supra* note 14.
[29] *See* Proposed Order, *supra* note 2, at 13 ("Although it is not required to establish broker status and is not in itself determinative of broker status, the receipt of transaction-based compensation in connection with securities activities, such as solicitation of potential investors, has been considered by courts as a factor indicating that registration as a broker may be required.") *See also* ABA Task Force Report, *supra* note 17, at 18 ("From the SEC staff's perspective, transaction-based compensation creates the incentive for abusive sales practices that registration is intended to regulate and prevent.").
[30] *See* Proposed Order, *supra* note 2, at 24.
[31] *See id.*, at 30 ("[T]he proposed conditions for both Tier I Finders and Tier II Finders should sufficiently restrict the scope of the proposed exemption such that permitting limited activities associated with solicitation in this narrow context would not implicate the need for regulation of these activities under the broker regulatory framework.").

the Commission and FINRA gain insight into the extent of fraud, abusive sales practices, or other problematic practices among finders operating in private markets.

Conditions for Exemption

Next we turn to a review of the individual conditions. One condition for the proposed exemption would prohibit Tier II Finders from providing advice as to the valuation or advisability of the investment. In our view, this condition elevates form over substance. We believe a finder who undertakes a series of actions – contacting a potential investor whom he already knows[32] for the specific purpose of discussing a potential investment, arrange a meeting in which the issuer can present and sell the investment to the offeree, and attend that very meeting – will provide a clear and unmistakable recommendation, even if not explicitly expressed, that the offeree should invest in the offering. The finder's mere presence in a sales meeting, even as a silent observer, represents an implicit but potent sales recommendation. In this context, the proposed condition prohibiting the Finder from "providing advice as to the valuation or advisability of the investment" does little if anything to mitigate the Finder's conflict of interest.[33]

We question whether it would even be workable or credible to permit the finder to attend the meeting between issuer and offeree, and yet prohibit the finder from "providing advice as to the valuation or advisability of the investment." In these circumstances, it would be only natural for the potential investor to ask for the finder's opinion of the investment. Just as the finder leveraged a pre-existing substantive relationship with the potential investor to arrange the meeting, it may be expected that the latter will turn to the finder for advice or a recommendation. How is the finder—whose compensation depends on the successful sale—likely to respond? And how will the Commission know whether the finder complies with the condition of the exemption? Under the proposed exemption, finders would be subject neither to record-keeping requirements nor to compliance exams.

Written Disclosure Statement and Accredited Investors

Another condition of the safe harbor would require Tier II Finders to provide potential investors with a written disclosure statement. Among other things, the disclosure would describe material conflicts, the Finder's compensation arrangement with the issuer, and an affirmative statement that the Tier II Finder is acting as an agent of the issuer, is not acting as an associated person of a broker-dealer, and is not undertaking a role to act in the investor's best interest.[34] The Tier II Finder would be required to obtain from the investor a dated written acknowledgment of receipt of the Tier II Finder's required disclosures.

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[32] The conditional exemption for both Tier 1 and 2 Finders would prohibit general solicitation, which generally would have the practical result of restricting finders to soliciting those with whom they have a pre-existing substantive relationship.

[33] It is worth noting the contrasting and far stricter treatment in the case of former SEC employees and their potential influence on the Commission. We acknowledge that the two cases are completely different, but nonetheless believe the contrasting approaches are instructive. Unless the SEC grants advance permission, former employees are restricted from communicating with the SEC for the first two years after their employment terminates. Former employees are instructed that their mere presence in itself can be construed as an effort to influence the Commission – even if they remain silent and are seated in the audience of a public meeting. In this case, it is a question of influence on the professional SEC staff and Commissioners themselves—who are highly educated, receive regular ethics training, and exhibit model levels of professionalism, sophistication, and probity. How much greater would be the likely influence of a finder on a potential investor when the two sit in the same room while an issuer makes an investment sales pitch. Our point is not to argue for reduced ethical standards in the case of former SEC employees, but instead to urge a stricter standard in the case of finders.

[34] *See* Proposed Order, *supra* note 2, at 25-26.

In our view, this disclosure statement cannot replace the comprehensive set of investor protections provided by the framework of broker rules. A buyer-beware disclosure, for example, is no substitute for the Regulation BI requirement for brokers not place their own interests ahead of their customers.[35] Moreover, the Reg BI Adopting Release specifically affirmed that the rule would apply to high-net-worth individuals (who would qualify as accredited investors).[36]

Among other conditions designed for investor protection, the proposed exemption for Tier I and Tier II Finders would 1) prohibit Finders from engaging in general solicitations and 2) require that potential investors be accredited investors or investors whom the Finder reasonably believes are accredited investors.[37] We agree that these two provisions are better than the alternatives of allowing general solicitations or allowing Finders to solicit non-accredited retail investors. But the proposed exemption would have the effect of excluding accredited investors from the protections of Reg BI when finders solicit them. That exclusion would go against the spirit of Reg BI and the promise of its adopting release to apply to high-net-worth individuals.[38] Likewise, when the Commission amended the Accredited Investor definition just three months ago, it affirmed that Reg BI would apply to broker-dealer's recommendations of private offerings.[39]

Moreover, as we have noted previously in other comment letters, the financial thresholds in the accredited investor definition have been eroded by nearly four decades of inflation.[40] As a result, we have significant concerns that the pool of accredited investors includes a substantial number of individuals who are not able to fend for themselves in private markets and have qualified as accredited investors only because of the erosion of the financial thresholds.

The Proposed Exemptive Order is Overly Broad, not Narrowly Tailored

The release describes the proposed exemptions as narrowly tailored. We disagree. Advocates of regulatory relief for finders have identified certain specific obligations that they believe should be reduced or waived.[41] These include the Net Capital Rule and certain financial recordkeeping and reporting requirements. A tailored SEC rulemaking for finders would determine whether to modify or waive each

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[35] We were among those who had advocated that Reg BI be strengthened beyond its final form. Nonetheless, we believe that Reg BI would add investor protection.

[36] *See* Regulation Best Interest Adopting Release, *supra* note 27, at 112-113 (stating, with respect to "institutional accounts" with total assets of at least $50 million, "…we have decided not to align our definition with FINRA's exclusion because we believe conflicted recommendations can also result in harm to high net-worth individuals. We believe the benefits of Regulation Best Interest justify compliance costs as these individuals could benefit from the protections included in Regulation Best Interest regardless of their net worth, which may not necessarily correlate to a particular level of financial sophistication." *See also* Commissioner Allison Herren Lee, Public Statement, "Regulating in the Dark: What We Don't Know About Finders Can Hurt Us" (Oct. 7, 2020) ("Lee Statement") (noting the discrepancy between the Proposed Order and the adopting releases for both Reg BI and the recent amendments to the "Accredited Investor" Definition).

[37] *See* Proposed Order, *supra* note 2, at 18.

[38] *See supra* note 36. *See also* Lee Statement *supra* note 36.

[39] *See* SEC, Amending the "Accredited Investor" Definition, Securities Act Release No. 10824 (Aug. 26, 2020) at 133-134 ("We also note that, as a result of Regulation Best Interest, a broker-dealer's recommendation of a private offering to a retail customer is required to be in the retail customer's best interest, without putting the financial or other interest of the broker ahead of the interest of the retail customer, which we expect will lead to a reduction of unmitigated conflicts of interests."). *See also* Lee Statement *id*.

[40] *See* CFA Institute Letter *supra* note 20.

[41] *See* ABA Task Force Report, *supra* note 17, at 51.

such rule on an individual basis. The proposal, in contrast, takes the overly broad approach of a blanket finders' exemption from the full set of broker rules (subject to the specified conditions of the exemption).

In addition, the Proposal fails to focus the exemption on small and emerging issuers. It emphasizes the role that finders play in bridging the gap between small businesses that need capital and investors who are interested in supporting emerging enterprises, particularly in areas that lack robust venture capital and angel investor networks.[42] And yet the proposed exemption would make no restriction whatsoever on the size of offerings or issuers. This discrepancy is inconsistent with the notion of a tailored rulemaking.

A Rule Proposal with an Economic Analysis Would Be More Appropriate

We believe that a rule proposal would be more appropriate than the proposed exemptive order to consider this issue. A rule proposal would better reflect the scope of the proposal and its impact on market transparency and investor protection. A rule proposal would also allow for a longer comment period (60 days instead of 30), and a more informed public debate.

Importantly, a rule proposal also would have the advantage of presenting an economic analysis. An economic analysis would establish an economic baseline,[43] including an assessment of the prevalence of fraud and other wrongdoing among individuals who hold themselves out as Finders.

In addition, an economic analysis would analyze the effects of the proposal on efficiency, competition, and capital formation.[44] This is especially needed because of the potential impact that the proposed exemption could have on smaller brokers. Even without the exemption, observers have highlighted the unfair competition that legitimate small brokers face from unscrupulous finders.[45]

The question arises as to whether the proposed exemption would lead to the development of a classic "lemons" market among Finders.[46] That is, would adverse selection lead to a market in which unscrupulous or low-quality Finders drive out legitimate or high-quality ones? An economic analysis trained on this question would be particularly valuable.

Conclusion

The Release invites public comment on whether the proposed exemption would provide sufficient investor protections.[47] For the reasons described above, we believe the answer to this question is an unequivocal no. We believe that the proposed far-reaching exemption from the set of broker rules is neither necessary nor in the public interest.

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[42] *See* Proposed Order, *supra* note 2, at 5. The Proposal also notes that finders may also help bridge gaps between traditionally underrepresented founders, such as women and minorities, and VC and start-up capital. *Id.* at 5. However, the proposal does not specify how it would address that gap.

[43] SEC, *Current Guidance on Economic Analysis in SEC Rulemakings*, Memorandum (March 6, 2012), at 6, available at https://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf.

[44] *See* Exchange Act, Section 3(f), 15 U.S.C. 78c(f).

[45] *See, e.g.*, ABA Task Force, *supra* note 17, at 14 ("A concern expressed to the Task Force is that the unregistered financial intermediary makes it very difficult for smaller registered, reputable broker-dealers to become involved in raising funds. Unscrupulous entities and individuals can make exorbitant promises, enter into exclusionary contracts with unconscionable terms, and abuse the unsophisticated small businessman without much difficulty."). *See also id.* at 12 ("These financial intermediaries can provide encouragement to cut legal corners. They often underprice legitimate firms or deter issuers from going to legitimate firms.").

[46] See George A. Akerlof, The Market for "Lemons": Quality Uncertainty and the Market Mechanism, 84 Q.J. Econ. 488, 495 (1970).

[47] *See* Proposed Order, *supra* note 2, at 36, Question 38.

In the past, finders' advocates have called for the Commission to spearhead a coordinated effort among federal and state securities regulators and self-regulatory organizations to establish a simplified system that would subject certain finders to a reduced but appropriate level of regulation. We believe that this constructive approach would offer a better path forward.

Should you have any question about our positions, please do not hesitate to contact Stephen Deane, CFA, at stephen.deane@cfainstitute.org or James C. Allen, CFA, at james.allen@cfainstitute.org or 434.227.1338.

Sincerely,

Sincerely,

/s/ James C. Allen

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