From: Jim Nail
To: NASAA Comments
Cc: Theresa Leets; bill.beatty@dfi.wa.gov; Erin Houston; Sabrina Wall
Subject: [EXTERNAL]Public Comments on Proposed NASAA Model Franchise Broker Registration Act
Date: Thursday, June 13, 2024 8:19:25 PM
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June 13, 2024

To:
Theresa Leets, Chair of the Project Group
Bill Beatty, Co-chair of the Section
Erin Houston, Co-chair of the Section

Dear NASAA representatives:

I would like to offer a few constructive thoughts about the current draft of the proposed Model Franchise Broker Registration Act.

I have a fairly relevant background for this discussion. I have been working as a franchise broker for just under five years, having previously been a FINRA-regulated Broker, as well as the co-owner (and a Representative) of a state-regulated Registered Investment Adviser. I have also been a regulated financial professional in the UK and in other countries. Allow me also to mention, in 30+ years in international investment, I have never faced an inquiry, a disciplinary action, a lawsuit or even a client complaint.

I would like, first, to comment on the draft Act on a broad, conceptual level. I will turn also to some very specific points, but I believe it is at least as important first to clarify some fundamentals.

Fundamental perspective on the draft Model Act

Your Request for Public Comment states that the proposed Model Act is loosely based on the registration requirements of Washington State. I have been registered with Washington State for years, and there is absolutely nothing unreasonable or unworkable about that registration framework. The essence of it is that brokers must annually disclose litigation or other material events arising over the previous 5 years that could cast doubt upon their professional or ethical standards. However, your Model Act goes much further than this. It attempts to import various features of broker-dealer regulation from the securities industry into franchise broker registration, in some cases even tightening that inappropriate regulatory framework. This is misguided and, if implemented, likely to have very deleterious effects.

Perhaps I could take a moment to describe my own process with clients. This may be helpful in showing how fundamentally different franchise broking is from the securities industry, and therefore how inappropriate it is to “borrow” key features of the securities regulatory

approach.

My own process

I generally present about seven (between 5 and 15) different franchises for my clients' consideration, from among the many hundreds of companies with which I have referral agreements. My presentation takes place after an extensive interview process, so that I can select specific opportunities suitable for the clients' skill-set and work preferences, time available, financial resources, monetary goals and requirements, educational and professional background, geographical location, ties in the community, age, family considerations, personality, even favorite hobbies, sports, etc. I present the companies as franchises that seem to me to make sense for the client, in view of what I learned in our prior interviews. I explain why I feel that way, and I may also highlight areas of possible mismatch, issues that raised questions for me, which the client may be able to clarify during their due diligence process. I then ask the client to decide whether any of these opportunities seem worthy of further investigation. Only if the answer is yes do I make any introduction to a franchisor. When I make the introduction, I carefully explain to the franchisor why that client seems suitable for their opportunity, but also where there might be areas of mismatch.

Following the introduction, I then support my client throughout the months-long due diligence process. I provide documentation advising them how to get the most out of the franchisor's so-called "discovery process," including by studying the franchise disclosures and by interviewing current franchisees. I provide documentation advising them how to understand the key items in a franchise disclosure document. I provide them with sample questions that they may wish to ask a franchisor, as well as sample questions to ask current franchisees. I strongly advise my clients to consult with a qualified franchise attorney before making any decisions, and when appropriate I refer the client to such an attorney. I also make introductions to financial intermediaries if needed, as well as to a CPA with extensive knowledge of franchising and of the financial structures and tax treatments most common in franchising. I try, of course, to provide all these support services at the highest professional level, to distinguish myself from competitors. However, I have spoken with dozens of franchise brokers, and all of them apply a process that is in its outline quite similar to mine. Indeed, this process is taught to every new broker by both of the two professional Associations I belong to (the FBA and the IFPG).

Not the same as the securities industry

There are very few parallels here to any of the services provided by a stock broker or even an investment adviser. Securities brokers' KYC processes are incomparably more shallow and indeed usually little more than a proof of identity. Investment advisers also focus primarily on a very few questions such as the client's age, wealth and subjective risk-aversion. Securities professionals do not perform hours of interviews to understand the client's needs. Nevertheless, clients tend to delegate far more authority to their securities brokers and

investment advisers (even including signatory and custodial powers) than they would ever contemplate with any franchise broker. Also, securities transactions tend to be fast-paced, with little opportunity for the client to perform deep research and comparisons. In the best case, they may read some broker research and look at various benchmarking ratios. A real investment hobbyist might go so far as to read an annual report, but this is very rare. In contrast, potential franchisees have a detailed learning process going well beyond merely the statutory disclosure documents, allowing them to achieve quite a deep understanding of the opportunities they are considering. I tell my clients that this is one of the advantages of franchising, and that is true. They are not even asked to make an investment decision until the multi-step and usually months-long discovery process is complete.

It is worth remembering that franchise brokers are never parties to any transaction. They help educate their clients, and then make introductions for them to specific franchises as requested by the client. True, the broker is paid a referral fee by the franchisor if the client is awarded the franchise and then goes on to join the franchise system. However, the decision to award the franchise is made exclusively by the franchisor; and the decision to join the franchise system is made exclusively by the client, following a lengthy due diligence process that normally takes 3-9 months.

During this time, the broker never controls any client funds, is not a signatory to any transaction by or for the client, and is not authorized to make promises on behalf of the client OR the franchisor. The broker is an information resource, never a middleman.

One more point of difference is worth mentioning. Namely, the majority of franchise brokers' clients do not ultimately purchase a franchise. It would be hard for me to estimate the percentage, but I believe I probably speak with at least 20-50 potential clients, and introduce at least 2-5 clients to a franchisor, for each deal that is ultimately done. Most of the time, I provide education and perspective free of charge, partly to build trust and rapport, partly to judge the potential client's investment qualifications, and partly to teach them the basic parameters of a franchise transaction so that they know what they are getting into. This is all fully appropriate, because our clients in franchising are contemplating not just a financial investment but the life-changing step to launch a new business. Again, I hope this serves to distinguish franchise brokerage from the securities industry, where there is a constant rapid flow of essentially anonymous transactions and a relative dearth of client-specific educational preparation.

Your Request for Public Comment claims that there have been complaints about franchise brokers attempting to hard-sell specific franchises to their clients, including by providing false financial information. No doubt this has happened, and of course it happens all the time in the securities industry, despite rigorous oversight by multiple authorities. However, in my experience, the slightest hint of a hard-sell in franchising is enough to lose a client's trust. Clients appreciate a broker's neutrality and objectivity, bringing knowledge and experience into play but leaving all the key decisions to the client. As to making false financial claims

about a franchise, that is of course already illegal. Everyone in the industry knows that financial claims may only be made if they come directly from the Item 19 of the franchisor's disclosure document. No doubt there are some criminals in the franchise broker industry, as in all industries, and presumably they break multiple laws, but that is a bit off the point when discussing the need for a new & intrusive registration requirement.

Specific problem points in the proposed Model Act

I won't go through the draft Model Act point-by-point. There are numerous aspects of the proposal that are likely to be unworkable and damaging to brokers but also to their clients and the franchisors. Let me just mention a shortlist of a few salient items.

1. The **sheer volume of regulatory language** and structure. Most franchise brokers are mom & pop shops consisting of one or two people. They cannot be asked to comply with a set of highly detailed rules such as those that broker-dealers and investment advisers navigate through to do their work. Financial companies can afford lawyers, compliance departments, procedural reviews, multipage reporting, months-long preparation for licensing exams, annual audits, etc, etc. This sort of thing would put me and many other franchise brokers out of business.
2. The proposed Model Act **misunderstands the actual functions of a franchise broker**. Franchise brokers do not "sell" franchises. They make introductions. They are not authorized to award the franchise. Until the franchisor accepts the candidate and makes an offer, there can be no sale or purchase of a franchise. The broker is not authorized to do this.
3. The **prohibited practices list** is not about prohibited practices; it is about being required to register. There is no actual reference to an action which is harmful to the public and which therefore should not be condoned.
4. The requirement for a regulator-written **general-purpose disclosure document** is likely to produce a lengthy set of warnings for the consumer, designed to give grounds for distrusting their franchise broker's integrity. This is extremely unfair and not paralleled in most industries. In the securities industry there may be some grounds for such treatment, in view of the pace, selling practices, anonymity, etc, of the industry. However the franchise brokerage industry is fundamentally different, as discussed above.
5. **Section 5, paragraph 2** is particularly disturbing. Clients know that franchise brokers are paid by the franchisor – this is always disclosed, because it means that the services are free of charge to the client. A requirement to disclose the specific amounts that may be earned in case a transaction happens is intrusive, unreasonable, and likely to be misleading for clients. Remember again, these are mom & pop shops, and disclosing referral fees is tantamount to disclosing the broker's gross personal income. This is not

the norm in any field. Moreover, the disclosure will not include a tutorial to show the incalculable hours that a broker spends educating clients free of charge.

6. **Section 6, paragraph 3** requires brokers to retain records for every franchise that is "offered" for a period of 10 years after the broker goes out of business. First of all, as I said earlier, franchise brokers do not "offer" any franchise for sale, nor are they empowered to do so. It is the franchisor – not the broker – who awards a franchise, giving the candidate an option to buy. But aside from this key point, the 10-year requirement is simply incredible. Even SEC-registered investment advisers only have a 5-year record-keeping obligation – and that is even if they are directly managing their client's money. The level of responsibility here is out of all proportion to the services rendered. Again, bear in mind that I show each client an average of around 7 companies, and the vast majority of clients do not buy any franchise. This paragraph is an amazing overreach showing significant misunderstanding of the industry it purports to regulate.

I am aware that this has been a lengthy comment. I hope someone will read it. Let me close by saying that as a franchise broker, I paid for extremely expensive training, and I continue paying monthly to maintain membership in Associations that provide ongoing education. I work very long hours, and I take my responsibilities just as seriously as when I worked in the securities industry. I do my best to be well-informed and to advise and support my clients honestly, with their best interests at heart. Therefore, I take sincere umbrage at such misleading and unreasonable comments as this, from Page 3 of the Project Group's Request for Public Comment:

"[Our Industry Advisors] … noted that franchise brokers currently have no educational or ethical standards."

Presumably this is supposed to mean that franchise brokers do not have such standards imposed upon them by a regulator. That is not what it says however, and the choice of words is indicative of a general approach that assumes the worst of an entire industry.

I hope that will not be the guiding spirit of any registration requirements actually adopted as the model for NASAA.

Thank you for your kind attention.

Sincerely,

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