



THE CHAIR

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

November 15, 2013

The Honorable Scott Garrett
U.S. House of Representatives
2129 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Garrett:

Thank you for your October 30, 2013 letter concerning the Securities and Exchange Commission's review of the definition of the term "accredited investor" in Regulation D. Your letter asks a series of questions about the Commission's review of this definition and expresses concerns about the conclusions presented in the recent Government Accountability Office report on the alternative criteria for qualifying as an accredited investor.¹

Commission staff, including staff from the Division of Corporation Finance and the Division of Economic and Risk Analysis, has begun a comprehensive review of the accredited investor definition. The review will encompass, among other things, the question of whether net worth and annual income should be used as tests for determining whether a natural person is an accredited investor. As part of that review, Commission staff also plans to consider and independently evaluate alternative criteria for the accredited investor definition suggested by the public and other interested parties. The GAO Report is one of many sources of information that the Commission staff will consider as part of its review. As your letter indicates, the Commission also has requested public comment on the accredited investor definition as part of our proposal to amend Regulation D, Form D, and Securities Act Rule 156,² and we look forward to considering the public views and suggestions on this issue as part of our review. Once the review is completed, the Commission will consider whether to change the definition through the notice and comment rulemaking process. As part of that process – as in other rulemakings – the Commission would engage in a thorough economic analysis of the impacts of various approaches to defining accredited investor.

As you indicate in your letter, Section 413(b)(2)(A) of the Dodd-Frank Wall Street Reform and Consumer Protection Act requires the Commission to undertake a review of the accredited investor definition in its entirety as it relates to natural persons four years after the enactment of the Act. I expect the review the staff is undertaking and the feedback received through that process will inform the Commission's consideration of whether or not to change the definition.

¹ *Alternative Criteria for Qualifying As An Accredited Investor Should be Considered* (July 18, 2013) ("GAO Report").

² *Amendments to Regulation D, Form D, and Rule 156*, Release No. 33-9416 (July 10, 2013) ("Proposing Release").

As the Commission staff's review has not yet been completed, I am not in a position to reach conclusions about possible changes to the accredited investor definition. As a general matter, your letter raises some of the core issues being considered under the staff's review. For example, some proposed definitions of accredited investor focus on including those individuals who can, through objective criteria such as profession or educational background, demonstrate that they are likely to be sophisticated investors who should be permitted to participate in Rule 506 offerings. Other proposed definitions turn on the ability of an individual to absorb investment losses, and thus look to criteria based on indicia such as net worth or income. Each of these and other approaches raise potential issues with implementation. Our consideration of possible changes to the definition of accredited investor will consider both the need to allow investment opportunities and the need to protect potentially vulnerable investors.

Your letter presents a series of questions about specific issues relating to the accredited investor definition and possible approaches for changing the definition. I have provided responses below. The numbers identified for each question below correspond to the questions contained in your letter.

- 1. We expect that permitting sophisticated investors, such as Certified Public Accountants ("CPAs") and Chartered Financial Analysts ("CFAs") to participate in private investment opportunities would improve information dissemination and analysis surrounding private investment opportunities. By excluding these highly trained financial professionals, unless they meet wealth or income tests, from investing in certain offerings, is the Commission placing existing accredited investors at greater risk? Would the review of investments by trained professionals with a vested interest help reveal problems of an issuer? Please perform an economic analysis that considers these points.**

The accredited investor definition is intended to serve to identify those individuals that should be permitted to participate in a Rule 506 offering. Professional certifications, such as a CPA or CFA, are among the possible supplemental or alternative criteria for qualifying as an accredited investor that Commission staff will consider as part of its review. Such a certification may position an individual to be able to analyze more comprehensively a company's financial condition and results of operations. Analysis of the income levels of various licensed professions may help to evaluate the marginal impacts, including on capital formation, of allowing for this type of qualification when compared to the current population of accredited investors. For example, certain of these licensed individuals may already qualify as accredited investors because of their income or net worth.

- 2. Do you agree that the inclusion of financially sophisticated smaller investors would increase the extent of expert review of smaller issuances in particular? Do you believe that less wealthy but sophisticated investors would be in a better position to pursue smaller investments that would otherwise be ignored by larger sophisticated investors? Please provide an economic analysis evaluating these points.**

The inclusion of more financially sophisticated investors – whether large or small – in the definition of accredited investor should increase the extent of the expert review of issuances. I do not currently have data to support whether less wealthy, financially sophisticated investors are better positioned to pursue smaller investments. The Proposing Release, however, requests public comment on the criteria that should be considered as an appropriate test for investment sophistication. The Commission staff's current review of the accredited investor definition will consider carefully comments that we receive on this issue, and will include an analysis by our Division of Economic and Risk Analysis of the economic implications of alternative approaches.

3. Do you agree that an expanded pool of potential accredited investors would help provide liquidity to private market investments, reducing risk to this type of investing? Please provide an analysis of the impact to liquidity that would result from any potential increase or decrease of accredited investors.

Expanding the pool of potential accredited investors could potentially increase the liquidity available for private market investments, though any change in the pool of accredited investors must take into account the qualifications of the investors that are being added to or subtracted from the pool. The degree to which the size and composition of the pool of accredited investors could affect liquidity and issuers' ability to raise capital through private offerings is one of the issues that the Commission staff is considering as part of its review. This consideration likely will include an analysis of the potential overlaps in the various pools of investors that could exist under various definitions. For example, including criteria other than income and net worth to determine whether an individual meets the accredited investor standard may not materially change the pool of accredited investors if there is significant overlap with the set of individuals who would qualify under an income or net worth test. If, however, including criteria other than income and net worth seems likely to materially increase the pool, further analysis could include evaluating possible investment levels by those additional investors and potential impacts on capital formation. I look forward to the staff's analysis once it completes the review.

4. With regard to CPAs, CFAs, those with securities licenses, and those with degrees in business, finance, accounting or economics, please provide an analysis of whether these certifications should provide an independent basis to qualify as an accredited investor.

The question of whether those with certain licenses (including CPAs, CFAs and securities licenses) or degrees should provide an independent basis to qualify as an accredited investor will be part of the staff's review. In addition, the Commission has received comments on the Proposing Release that address this issue as well. Holding a particular license or degree may provide an individual with the knowledge and sophistication necessary to qualify as an accredited investor. At the same time, some may argue that an academic background should not, on its own, be sufficient to qualify as an accredited investor. We will consider carefully comments on this issue as part of the Commission staff's review of the definition of accredited investor.

5. Why should experienced financial professionals, such as registered investment advisers, consultants, brokers, traders, portfolio managers, analysts, compliance staff, legal counsel and regulators, be required to independently qualify as accredited investors based on a wealth test?

The question of whether a person's net worth should continue to be used in the accredited investor definition is one of the issues that the Commission staff is examining as part of its review. The Proposing Release solicited public comment on this question as well. We have received comments supporting your suggestion that experienced financial professionals should be deemed to be sufficiently sophisticated to participate in Rule 506 offerings, irrespective of their net worth. We have also received comments suggesting that there is a need for some criteria based on a person's net worth or income in order to measure the person's ability to absorb the potential loss of his or her investment. Staff will consider these comments carefully in its review, with a focus on assessing the impact the current definition and any alternative definitions has had or would have on capital formation and identifying those investors who most benefit from safeguards not available in an offering conducted under Rule 506.

6. Should reliance on a qualified broker or registered investment adviser enable ordinary investors to participate in Regulation D Rule 506 offerings? Why or why not?

An investor's reliance on a registered broker or investment adviser is one of many factors that the Commission staff will consider as part of its review of the accredited investor definition. Obtaining the advice of a professional advisor may enhance an investor's ability to make an informed investment decision and therefore strengthen investor protection in Rule 506 offerings. An investor's use of such an advisor, however, may not necessarily measure the investor's understanding of the risks of the investment. As part of its review, the Commission staff may determine that it is feasible to analyze the extent to which investors file claims against professional advisors arising from investments in unregistered offerings. Such an analysis may assist in evaluating the level of protection afforded to investors when relying on professional advisors.

7. Please provide an analysis of whether disclosure by those private issuers that anticipate using Regulation D 506(c) has increased following the lifting of the ban on general solicitation. If not, have the compliance challenges associated with the Proposed Amendments to Regulation D inhibited these potential 506(c) issuers from taking full advantage of the lifting of the ban?

Issuers are not required to comply with any of the Proposing Release's rule amendments until such time as the Commission may approve the amendments and the amendments become effective. Should the Commission ultimately decide to adopt amendments, I expect that the final rules would consider the need for transitional guidance for ongoing offerings that commenced before the effective date of the final rules. Therefore, there should not be compliance challenges associated with the proposed rule amendments and issuers should not feel inhibited from using the Rule 506(c) exemption as a result of the proposed rule amendments.

With respect to your question on the disclosures provided by issuers using the Rule 506(c) exemption, I believe it is important that the Commission and its staff have the ability to evaluate the market impact and developing market practices resulting from the ability to use general solicitation in Rule 506(c) offerings. That is why the Commission has directed the staff to execute a comprehensive work plan to review and analyze the use of Rule 506(c) and market practices. It also is one of the primary reasons why the Commission issued the Proposing Release, which, if the proposed rules are adopted, would enhance the ability of the Commission to review and assess market practices, such as disclosure practices of issuers.

8. The Regulation D 506 market raises equity capital in excess of one trillion dollars annually, a level that exceeds that of the combined public debt and equity markets. Would diminishing the pool of eligible investors potentially harm U.S. GDP? Why or why not?

As part of the Commission staff's review of the definition of accredited investor, it will consider the potential economic consequences of using alternative criteria to qualify as an accredited investor. Understanding these potential economic consequences will be an integral component of the review and an essential part of the staff's work during this process. In July 2013, staff in the Commission's Division of Economic and Risk Analysis released their analysis of capital raising in the U.S. through unregistered offerings.³ The analysis discussed, among other things, findings about the amount of capital raised through Regulation D offerings on an annual basis and information about the investors that participate in these offerings. The analysis will be one of the many sources of information that the Commission staff will consider as it reviews the definition of accredited investor. The staff also will consider whether, as part of the review, it is possible to analyze changes in the pool of accredited investors since the adoption of the current definition of accredited investors. It is most likely, of course, that the pool has expanded, as the current income and net worth tests have not been inflation-adjusted and, as a general matter, salaries have increased over time. If the Commission ultimately decides to propose rules to change the definition of accredited investor after this review, it would be appropriate to evaluate potential changes to the size of the pool of eligible investors and the resultant economic impacts on capital formation. The Commission staff may also analyze the extent to which issuers currently use existing safe harbors to obtain investments from non-accredited investors.

9. Please provide all communications between the GAO and the SEC within the past 18 months referring or relating to the definition of accredited investors.

I understand that Commission staff is far along in identifying documents responsive to your request. The staff has informed me that they expect to seek Commission authorization to release the responsive communications as expeditiously as possible and will keep your staff apprised as to the status.

³ See Vladimir Ivanov and Scott Bauguess, *Capital Raising in the U.S.: An Analysis of Unregistered Offerings Using the Regulation D Exemption, 2009-2012* (July 2013), available at <http://www.sec.gov/divisions/riskfin/whitepapers/dera-unregistered-offerings-reg-d.pdf>.

The Honorable Scott Garrett
Page 6

I hope you find this information helpful. Because your letter relates to questions asked in the Proposing Release on which the Commission is soliciting public comment, your letter will be added to our official comment file. Please contact me at (202) 551-2100, or your staff may contact Tim Henseler, Director of the Office of Legislative and Intergovernmental Affairs, at (202) 551-2010, if you have any questions or comments.

Sincerely,



Mary Jo White
Chair