SECURITIES AND EXCHANGE COMMISSION

17 CFR PARTS 230 and 240

Release Nos. 33-10734; 34-87784; File No. S7-25-19

RIN 3235-AM19

Amending the "Accredited Investor" Definition

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: We are proposing amendments to the definition of "accredited investor" in our rules to add new categories of qualifying natural persons and entities and to make certain other modifications to the existing definition. The proposed amendments are intended to update and improve the definition in order to identify more effectively institutional and individual investors that have the knowledge and expertise to participate in our private capital markets and therefore do not need the additional protections of registration under the Securities Act of 1933. Specifically, the proposed amendments would add new categories of natural persons that may qualify as accredited investors based on certain professional certifications or designations or other credentials or their status as a private fund's "knowledgeable employee;" expand the list of entities that may qualify as accredited investors and allow entities meeting an investments test to qualify; add family offices with at least $5 million in assets under management and their family clients; and add the term "spousal equivalent" to the definition. We are also proposing amendments to the qualified institutional buyer definition in Rule 144A under the Securities Act that would expand the list of entities that are eligible to qualify as qualified institutional buyers.

DATES: Comments should be received on or before 60 days after publication in the Federal Register.

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/proposed.shtml); or
- Send an email to rule-comments@sec.gov. Please include File Number S7-25-19 on the subject line.

Paper comments:

- Send paper comments to Vanessa A. Countryman, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-25-19. This file number should be included on the subject line if email is used. To help us process and review your comments more efficiently, please use only one method of submission. The Commission will post all comments on the Commission's website (http://www.sec.gov/rules/proposed.shtml). Comments also are available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549-1090 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly.

We or the staff may add studies, memoranda, or other substantive items to the comment file during this rulemaking. A notification of the inclusion in the comment file

of any such materials will be made available on our website. To ensure direct electronic receipt of such notifications, sign up through the "Stay Connected" option at www.sec.gov to receive notifications by e-mail.

FOR FURTHER INFORMATION CONTACT: Charles Kwon, Senior Counsel, Office of Rulemaking, or Charlie Guidry, Special Counsel, Office of Small Business Policy, at (202) 551-3460, Division of Corporation Finance; Jennifer Songer, Branch Chief, or Lawrence Pace, Senior Counsel, at (202) 551-6999, Investment Adviser Regulation Office, Division of Investment Management; U.S. Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549.

SUPPLEMENTARY INFORMATION: We are proposing amendments to 17 CFR 230.144A ("Rule 144A"), 17 CFR 230.163B ("Rule 163B"), 17 CFR 230.215 ("Rule 215"), and 17 CFR 230.501 ("Rule 501") of 17 CFR 230.500 through 230.508 ("Regulation D") under the Securities Act of 1933 ("Securities Act");[1] and 17 CFR 240.15g-1 ("Rule 15g-1") under the Securities Exchange Act of 1934 ("Exchange Act").[2]

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[1] 15 U.S.C. 77a *et seq*.

[2] 15 U.S.C. 78a *et seq.*

I. INTRODUCTION

On June 18, 2019, the Commission issued a concept release that solicited public comment on possible ways to simplify, harmonize, and improve the exempt offering framework under the Securities Act of 1933 to promote capital formation and expand investment opportunities while maintaining appropriate investor protections.[3] In the Concept Release, the Commission requested comments on possible approaches to amending the definition of "accredited investor" in Rule 501(a) of Regulation D. This definition is a central component of several exemptions from registration such as Rules 506(b) and 506(c) of Regulation D, and plays an important role in other federal and state securities law contexts. Qualifying as an accredited investor is significant because accredited investors may, under Commission rules, participate in investment opportunities that are generally not available to non-accredited investors, such as investments in private companies and offerings by certain hedge funds, private equity funds, and venture capital funds.

In view of the significance of the accredited investor definition in the exempt offering framework, we are proposing to amend the accredited investor definition as an initial step in a broader effort to consider ways to harmonize and improve this

[3] Concept Release on Harmonization of Securities Offering Exemptions, Release No. 33-10649 (June 18, 2019) [84 FR 30460 (June 26, 2019)] ("Concept Release").

framework. We believe that this proposal to update the accredited investor definition would provide a foundation for our ongoing efforts to assess whether our exempt offering framework, as a whole, is consistent, accessible, and effective for both issuers and investors. In addition to these proposed rule amendments, we are continuing to evaluate the comments received on the Concept Release in connection with possible future rulemaking proposals relating to the exemptions from registration under the Securities Act.

The Concept Release was preceded by a staff report[4] on the accredited investor definition issued in December 2015. The 2015 Staff Report examined the background and history of the definition and considered comments and recommendations from the public, the Commission's Investor Advisory Committee,[5] the Commission's Advisory Committee on Small and Emerging Companies,[6] and the 2014 SEC Government-Business Forum on Small Business Capital Formation.[7] The 2015 Staff Report also presented staff recommendations on amending the definition and analyzed the impact of potential approaches to amending the definition on the pool of accredited investors. The Commission staff prepared the report pursuant to Section 413(b)(2)(A) of the Dodd-

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[4] *See* Report on the Review of the Definition of "Accredited Investor" (Dec. 18, 2015) ("2015 Staff Report"), *available at* https://www.sec.gov/corpfin/reportspubs/special-studies/review-definition-of-accredited-investor-12-18-2015.pdf.

[5] *See* Recommendation of the Investor as Purchaser Subcommittee and the Investor Education Subcommittee of the Investor Advisory Committee: Accredited Investor Definition (Oct. 9, 2014), (the "2014 Investor Advisory Committee Recommendation"), *available at* http://www.sec.gov/spotlight/investor-advisory-committee-2012/accredited-investor-definition-recommendation.pdf.

[6] *See* Advisory Committee on Small and Emerging Companies: Recommendations Regarding the Accredited Investor Definition (March 9, 2015) (the "2015 ACSEC Recommendations"), *available at* http://www.sec.gov/info/smallbus/acsec/acsecaccredited-investor-definition-recommendation-030415.pdf.

[7] *See* Final Report of the 2014 SEC Government-Business Forum on Small Business Capital Formation (May 2015), *available at* http://www.sec.gov/info/smallbus/gbfor33.pdf.

Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"),[8] which directs the Commission to review the accredited investor definition as the term relates to natural persons at least once every four years to determine whether the definition "should be adjusted or modified for the protection of investors, in the public interest, and in light of the economy."[9] The Commission received over 50 comment letters on the 2015 Staff Report and subsequently received recommendations on possible revisions to the accredited investor definition from the Advisory Committee on Small and Emerging Companies[10] and the annual SEC Government-Business Forum on Small Business Capital Formation.[11]

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[8] Pub. L. No. 111-203, 124 Stat. 1376 (2010).

[9] Section 413(b)(2)(A) states that this Commission review must be conducted not earlier than four years after the enactment of the Dodd-Frank Act and not less frequently than once every four years afterward.

[10] *See* Advisory Committee on Small and Emerging Companies: Recommendations Regarding the Accredited Investor Definition (July 20, 2016) (the "2016 ACSEC Recommendations"), *available at* https://www.sec.gov/info/smallbus/acsec/acsec-recommendations-accredited-investor.pdf.

[11] Each of the Final Reports of the 2016, 2017, and 2018 SEC Government-Business Forums on Small Business Capital Formation included a recommendation that the Commission maintain the monetary thresholds for accredited investors and expand the categories of qualification for accredited investor status based on various types of sophistication such as education, experience, and training. *See* Final Report of the 2016 SEC Government-Business Forum on Small Business Capital Formation (March 2017) (the "2016 Small Business Forum Report"), *available at* https://www.sec.gov/info/smallbus/gbfor35.pdf; Final Report of the 2017 SEC Government-Business Forum on Small Business Capital Formation (March 2018) (the "2017 Small Business Forum Report"), *available at* https://www.sec.gov/files/gbfor36.pdf; and Final Report of the 2018 SEC Government-Business Forum on Small Business Capital Formation (June 2019) (the "2018 Small Business Forum Report"), *available at* https://www.sec.gov/info/smallbus/gbfor37.pdf.

The Final Report of the 2019 SEC Government-Business Forum on Small Business Capital Formation included a recommendation that the Commission should revise the accredited investor definition as follows: (1) for natural persons, in addition to the income and net worth thresholds in the definition, add a sophistication test as an additional way to qualify; (2) provide tribal governments parity with state governments; and (3) revise the dollar amounts to scale for geography, lowering the thresholds in states/regions with a lower cost of living. See Final Report of the 2019 SEC Government-Business Forum on Small Business Capital Formation (December 2019) (the "2019 Small Business Forum Report"), *available at* https://www.sec.gov/files/small-business-forum-report-2019.pdf.

Many of the comments submitted in response to the Concept Release[12] urged the Commission to expand the accredited investor definition.[13] Other commenters opposed changing the definition or stated that the Commission should narrow the definition,[14] while a few commenters recommended that the Commission eliminate the definition altogether.[15] Commenters expressed a range of views on whether the Commission should amend the financial thresholds currently in the accredited investor definition,[16] and a number of commenters urged the Commission to maintain objective standards in the

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[12] Unless otherwise indicated, comments cited in this release are to comment letters received in response to the Concept Release, which are *available at* https://www.sec.gov/comments/s7-08-19/s70819.htm.

[13] *See*, *e.g.*, letters from Federal Regulation of Securities Committee, Business Law Section of the American Bar Association dated October 16, 2019 ("ABA Fed. Reg. of Sec. Comm. Letter"); Island Mountain Development Group dated September 24, 2019 ("IMDG Letter"); Association for Corporate Growth dated September 24, 2019 ("ACG Letter"); Investments and Wealth Institute dated September 12, 2019 ("IWI Letter"); Securities Regulation Committee, Business Law Section of the New York State Bar Association dated October 18, 2019 ("Sec. Reg. Comm. of NY St. B.A. Letter"); Small Business Investor Alliance dated September 25, 2019 ("2019 SBIA Letter"); BlackRock, Inc. dated September 24, 2019 ("BlackRock Letter"); Artivest Holdings, Inc. dated October 8, 2019 ("Artivest Letter"); EquityZen Inc. dated September 30, 2019 ("EquityZen Letter"); Alfonso Ceja dated October 15, 2019 ("A. Ceja Letter"); CoinList dated September 26, 2019 ("CoinList Letter"); H. Konings et al. dated September 24, 2019 ("H. Konings et al. Letter"); Institute for Portfolio Alternatives dated September 24, 2019 ("IPA Letter"); Jeff Thomas dated September 24, 2019 ("J. Thomas Letter"); McCarter & English LLP dated September 24, 2019 ("McCarter & English Letter"); Center for Capital Markets Competitiveness of the U.S. Chamber of Commerce dated September 24, 2019 ("CCMC Letter"); CFA Institute dated September 24, 2019 ("CFA Institute Letter"); Marketplace Lending Association dated September 23, 2019 ("MLA Letter"); Funding Circle dated September 23, 2019 ("Funding Circle Letter"); Bridgeport Financial Technology dated September 20, 2019 ("Bridgeport Letter"); Jor Law dated July 6, 2019; Kyle Sonlin dated June 26, 2019 ("K. Sonlin Letter"); John Tapp dated June 19, 2019 ("J. Tapp Letter"); Private Investor Coalition dated September 24, 2019 ("2019 PIC Letter"); California Municipal Treasurers Association dated September 20, 2019 ("CMTA Letter"); Native American Finance Officers Association dated September 12, 2019 ("NAFOA Letter"); Investment Adviser Association dated October 18, 2019 ("IAA Letter"); Managed Funds Association and Alternative Investment Management Association dated September 24, 2019 ("MFA and AIMA Letter"); Crowdfunding Professionals Association, Legislative & Regulatory Affairs Division, dated October 15, 2019 ("CfPA Letter"); Joseph L. Schocken dated September 24, 2019 ("J. Schocken Letter"); Alternative & Direct Investment Securities Association dated September 24, 2019 ("ADISA Letter"); Jeff LaBerge dated September 6, 2019 ("J. LaBerge Letter"); and Association of Online Investment Platforms dated July 5, 2019 ("AOIP Letter").

[14] *See*, *e.g.*, letters from Consumer Federation of America dated October 1, 2019 ("Consumer Federation Letter") and Forum for U.S. Securities Lawyers in London dated September 24, 2019.

[15] *See*, *e.g.*, letters from Nathan Eames dated September 1, 2019 and Andrew Deville dated June 19, 2019.

[16] *See infra* Section III.

definition.[17] Some commenters suggested that the Commission harmonize the accredited investor definition with the definitions of "qualified purchaser" under the Investment Company Act of 1940 (the "Investment Company Act"), "qualified client" under the Investment Advisers Act of 1940 (the "Advisers Act"), and/or "qualified institutional buyer" as defined in Rule 144A under the Securities Act.[18]

Commenters on the Concept Release offered a number of suggestions for expanding the accredited investor definition to provide natural persons and entities with additional means of qualifying for accredited investor status. Some commenters suggested that the Commission amend the definition to deem natural persons with additional measures of financial sophistication, other than annual income or net worth, eligible for accredited investor status, such as professional certifications,[19] prior experience in investing in securities,[20] status as a "knowledgeable employee" as defined in 17 CFR 270.3c-5 under the Investment Company Act ("Rule 3c-5"),[21] or an accredited investor examination.[22] Several commenters urged the Commission to amend the accredited investor definition to include natural persons or entities that are advised by a

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[17] *See*, *e.g.*, ABA Fed. of Sec. Reg. Comm. Letter; letter from Securities Industry and Financial Markets Association dated September 24, 2019 ("SIFMA Letter"); BlackRock Letter; and MFA and AIMA Letter.

[18] *See*, *e.g.*, ABA Fed. Reg. of Sec. Comm. Letter; IAA Letter; Sec. Reg. Comm. of NY St. B.A. Letter; SIFMA Letter; BlackRock Letter; and letter from Shartsis Friese LLP dated September 24, 2019 ("Shartsis Friese Letter").

[19] *See infra* Section II.B.1.

[20] *See*, *e.g.*, CCMC Letter; letter from Institutional Capital Network dated September 24, 2019 ("iCapital Network Letter"); CFA Institute Letter; and letter from Charlie Uchill dated August 9, 2019 ("C. Uchill Letter").

[21] *See infra* Section II.B.2.

[22] *See*, *e.g.*, ACG Letter; J. Thomas Letter; CCMC Letter; MLA Letter; Funding Circle Letter; letter from Hedge Fund Association dated September 23, 2019 ("HFA Letter"); and letter from Wefunder dated September 13, 2019 ("Wefunder Letter").

financial professional, such as a registered investment adviser that acts as a fiduciary in making the investment,[23] while other commenters opposed this view.[24] Commenters also recommended that the Commission expand the accredited investor definition to include family offices and clients of family offices, as defined in 17 CFR § 275.202(a)(11)(G)-1 under the Advisers Act ("Rule 202(a)(11)(G)-1"),[25] registered investment advisers,[26] entities with investments over a certain threshold (*e.g.*, $5 million),[27] Indian tribes,[28] and certain state and local governments.[29]

After considering these comments and recommendations, we are proposing to amend the accredited investor definition in Rule 501(a) of Regulation D by modifying a number of the definition's existing categories and by adding new categories to the definition.[30] Specifically, we are proposing to:

- Add new categories to the definition that would permit natural persons to qualify as accredited investors based on certain professional certifications or designations

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[23] *See*, *e.g.*, IAA Letter; Artivest Letter; letter from MarketPlus Capital Company dated October 8, 2019; EquityZen Letter; 2019 SBIA Letter; IPA Letter; BlackRock Letter; iCapital Network Letter; letter from Davis Polk & Wardwell LLP dated September 24, 2019 ("Davis Polk Letter"); letter from Iownit Capital and Markets, Inc. dated September 24, 2019 ("Iownit Letter"); and Wefunder Letter.

[24] *See*, *e.g.*, letters from Public Investors Advocate Bar Association dated September 24, 2019 ("PIABA Letter"); Investment Company Institute dated September 24, 2019 ("ICI Letter"); and Angel Capital Association dated September 23, 2019 ("ACA Letter").

[25] *See infra* Section II.C.6.

[26] *See infra* Section II.C.1.

[27] *See infra* Section II.C.4.

[28] *See*, *e.g.*, letter from Rosebud Economic Development Corporation dated September 24, 2019 ("REDCO Letter"); IMDG Letter; letter from Gavin Clarkson dated September 22, 2019 ("G. Clarkson Letter"); and NAFOA Letter.

[29] *See*, *e.g.*, CMTA Letter.

[30] We are also proposing conforming amendments to the accredited investor definition in Rule 215 under the Securities Act. The Rule 215 and Rule 501(a) definitions of accredited investor historically have been substantially consistent but not identical. *See* discussion in Section II.E.

or credentials from an accredited educational institution or, with respect to investments in a private fund, based on the person's status as a "knowledgeable employee" of the fund;[31]

- Add certain entity types to the current list of entities that may qualify as accredited investors, as well as add a new category for any entity owning "investments," as defined in 17 CFR 270.2a51-1(b) under the Investment Company Act ("Rule 2a51-1(b)"), in excess of $5 million and that was not formed for the specific purpose of investing in the securities offered;
- Add "family offices" with at least $5 million in assets under management and their "family clients," as each term is defined under the Advisers Act;
- Add the term "spousal equivalent" to the accredited investor definition, so that spousal equivalents may pool their finances for the purpose of qualifying as accredited investors; and
- Codify certain staff interpretive positions that relate to the accredited investor definition.[32]

In addition, we are proposing to amend the definition of "qualified institutional buyer" in Rule 144A(a)(1)[33] to include additional entity types that meet the $100 million threshold to avoid inconsistencies between the types of entities that are eligible for accredited investor status and those that are eligible for qualified institutional buyer status under Rule 144A.

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[31] A private fund is an issuer that would be an investment company, as defined in Section 3 of the Investment Company Act, but for Sections 3(c)(1) or 3(c)(7) of that Act. *See* Section 202(a)(29) of the Advisers Act.

[32] *See infra* Sections II.B.3, II.C.3, and II.C.5.

[33] 17 CFR 230.144A(a)(1).

The amendments we propose today are the product of many years of efforts by the Commission and its staff to consider and analyze possible approaches to revising the accredited investor definition. A number of the proposed amendments are consistent with those recommended by the Commission staff in the 2015 Staff Report, while some of the proposed amendments are substantially similar to those the Commission proposed in 2007.[34] Many of the proposed amendments have been recommended in the past, in one form or another, by the Advisory Committee on Small and Emerging Companies, the Investor Advisory Committee, and a wide array of public commenters.

Unregistered offerings conducted under Regulation D, particularly those under Rule 506(b), play a significant role in capital formation in the United States. In 2018, the estimated amount of capital (including both equity and debt) reported as being raised in Rule 506 offerings was $1.7 trillion,[35] compared to $1.4 trillion raised in registered offerings.[36] Of the $1.7 trillion, $1.5 trillion was raised by pooled investment funds, and $228 billion was raised by non-fund issuers. As noted in the 2015 Staff Report, and as

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[34] Revisions of Limited Offering Exemptions in Regulation D, Release No. 33-8828 (Aug. 3, 2007) [72 FR 45116 (Aug. 10, 2007)] ("2007 Proposing Release").

[35] *See* Concept Release at 30466.

[36] *See* Concept Release at 30465. Unless otherwise indicated, information in this release on Regulation D offerings is based on analysis by staff in the Commission's Division of Economic and Risk Analysis ("DERA") of data collected from Form D filings on the Commission's Electronic Data Gathering, Analysis, and Retrieval system ("EDGAR") from January 2009 through December 2018. DERA staff determined the amount raised based on the amounts reported as "Total amount sold" in all Form D filings (new filings and amendments) on EDGAR. Subsequent amendments to a new filing were treated as incremental fundraising and recorded in the calendar year in which the amendment was filed. It is likely that the reported data on Regulation D offerings underestimates the actual amount raised through these offerings for two reasons. First, 17 CFR 230.503 ("Rule 503") of Regulation D requires issuers to file a Form D no later than 15 days after the first sale of securities, but a failure to file the notice does not invalidate the exemption. Accordingly, despite the filing requirement, it is possible that some issuers do not file Forms D for offerings relying on Regulation D. Second, underreporting could also occur because a Form D may be filed prior to completion of the offering, and our rules do not require issuers to amend a Form D to report the total amount sold on completion of the offering or to reflect additional amounts offered if the aggregate offering amount does not exceed the original offering size by more than 10%.

discussed further in Section VII below, accredited investors are critical to providing capital for the Regulation D market. There may be investment opportunities, particularly with respect to early stage and high growth firms, in the Regulation D market that are not available to investors in registered securities offerings.[37] At the same time, investors in the Regulation D market can be subject to investment risks not associated with registered offerings because, for example, issuers in this market generally are not required to provide information comparable to that included in a registration statement.

Accordingly, in proposing changes to the definition, and in particular changes in the types of natural persons that would qualify as an "accredited investor" under these amendments, we have considered investor protection concerns, including concerns about an investor's ability to participate in and supply capital to the Regulation D market. As discussed below, the accredited investor definition is a central component of Regulation D. We are mindful that an overly broad definition could potentially undermine important investor protections and reduce public confidence in this vital market. At the same time, an unnecessarily narrow definition could limit investor access to investment opportunities where there may be adequate investor protection given factors such as that investor's financial sophistication, net worth, knowledge and experience in financial matters, or amount of assets under management.[38] The amendments to the accredited investor definition we propose in this release reflect a

[37] For example, according to Ritter (2019), the median age of a firm that went public in 1999 was 5 years, while in 2018 the median age was 10 years, *see* https://site.warrington.ufl.edu/ritter/files/2019/03/IPOs2018Age.pdf.

[38] *See* 15 U.S.C. 77b(a)(15)(i) and (ii) (establishing several categories of accredited investors and authorizing the Commission to adopt additional categories based on "such factors as financial sophistication, net worth, knowledge, and experience in financial matters, or amount of assets under management").

balancing of these considerations and, along with the Commission's periodic reviews of the definition pursuant to the Dodd-Frank Act,[39] are part of an ongoing effort to update and enhance this definition.

We welcome feedback and encourage interested parties to submit comments on any or all aspects of the proposed amendments. When commenting, it would be most helpful if you include the reasoning behind your position or recommendation.

II. PROPOSED AMENDMENTS TO THE ACCREDITED INVESTOR DEFINITION

A. Background

The current exemptions from Securities Act registration include a variety of requirements, investor protections, and other conditions, including, in many cases, restrictions on the types of investors that are permitted to participate in the offering. *SEC v. Ralston Purina*,[40] the leading case interpreting the Section 4(a)(2) exemption, addressed the characteristics of the investors involved in an offering exempt from registration.[41] That decision set forth the position that the availability of the Section 4(a)(2) exemption should turn on whether the particular class of persons affected needs the protection of the Securities Act. The Commission has over the years adopted rules to provide greater certainty about exempt offerings that are consistent with the basic criteria set forth in *Ralston Purina*. For example, Rule 146—a predecessor to Regulation D adopted in 1974—permitted offers and sales only to persons the issuer

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[39] *See supra* note 9.

[40] 346 U.S. 119, 125 (1953).

[41] Section 4(a)(2) [15 U.S.C. 77(d)(a)(2)] exempts transactions by an issuer "not involving any public offering" from the Securities Act's registration requirements.

reasonably believed had the requisite knowledge and experience in financial matters to evaluate the risks and merits of the prospective investment or who could bear the economic risks of the investment.[42] Later, Rule 242 introduced the accredited investor concept into the federal securities laws, providing a limited offering exemption up to $2 million with various conditions and defining an "accredited person" as a person purchasing $100,000 or more of the issuer's securities, a director or executive officer of the issuer, or a specified type of entity.[43]

Congress subsequently enacted the Small Business Investment Incentive Act of 1980,[44] which exempted from Securities Act registration non-public offers and sales of securities up to $5 million made solely to accredited investors[45] and added the accredited investor definition to Section 2(a)(15) of the Securities Act. Section 2(a)(15)(i) defines accredited investor to mean certain enumerated entities, and Section 2(a)(15)(ii) authorizes the Commission to adopt additional categories based on "such factors as financial sophistication, net worth, knowledge, and experience in financial matters, or amount of assets under management." The Commission has used this authority to expand the types of persons that qualify as accredited investors, as described below.

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[42] *See* Transactions By an Issuer Deemed Not To Involve Any Public Offering, Release No. 33-5487 (Apr. 23, 1974) [39 FR 15261 (May 2, 1974)]. If all the conditions of Rule 146 were met, the offer and sale of securities were deemed to not involve any public offering within the meaning of Section 4(a)(2). The Commission rescinded Rule 146 in 1982 in connection with the adoption of Regulation D.

[43] *See* Exemption of Limited Offers and Sales by Qualified Issuers, Release No. 33-6180 (Jan. 17, 1980) [45 FR 6362 (Jan. 28, 1980)] ("Rule 242 Adopting Release"). The Commission rescinded Rule 242 in 1982 in connection with the adoption of Regulation D.

[44] Pub. L. No. 96-477, 94 Stat. 2275 (1980).

[45] Securities Act Section 4(a)(5) [15 U.S.C. 77(d)(a)(5)].

Historically, the Commission has stated that the accredited investor definition is "intended to encompass those persons whose financial sophistication and ability to sustain the risk of loss of investment or fend for themselves render the protections of the Securities Act's registration process unnecessary."[46] The characteristics of an investor encompassed within this standard can be demonstrated in a variety of ways. These include the ability to assess an investment opportunity—which includes the ability to analyze the risks and rewards, the capacity to allocate investments in such a way as to mitigate or avoid risks of unsustainable loss, or the ability to gain access to information about an issuer or about an investment opportunity—or the ability to bear the risk of a loss.[47]

[46] Regulation D Revisions; Exemption for Certain Employee Benefit Plans, Release No. 33-6683 (Jan. 16, 1987) [52 FR 3015 (Jan. 30, 1987)]. *See also SEC v. Ralston Purina Co*., 346 U.S. 119, 125 (1953) (taking the position that the availability of the Section 4(a)(2) exemption "should turn on whether the particular class of persons affected needs the protection of the Act. An offering to those who are shown to be able to fend for themselves is a transaction 'not involving any public offering.'").

[47] The accredited investor standard is similar to, but distinct from, other regulatory standards in Commission rules that are used to identify persons who are not in need of certain investor protection features of the federal securities laws. For example, Section 3(c)(7) of the Investment Company Act excepts from the definition of investment company any issuer, the outstanding securities of which are owned exclusively by persons who, at the time of acquisition of such securities, are qualified purchasers, and which is not making and does not at that time propose to make a public offering of securities. Congress defined qualified purchasers as: (i) natural persons who own not less than $5 million in investments; (ii) family-owned companies that own not less than $5 million in investments; (iii) certain trusts; and (iv) persons, acting for their own accounts or the accounts of other qualified purchasers, who in the aggregate own and invest on a discretionary basis, not less than $25 million in investments (*e.g.*, institutional investors). These other regulatory standards each serve a different regulatory purpose. Accordingly, an accredited investor will not necessarily meet these other standards and these other regulatory standards are not designed to capture the same investor characteristics as the accredited investor standard. *See also* 2015 Staff Report, *supra* note 4, at section III.

Regulation D, adopted in 1982,[48] is a series of rules that sets forth exemptions and a safe harbor from the registration requirements of the Securities Act.[49] Rule 506(b) of Regulation D is a non-exclusive safe harbor under Section 4(a)(2) of the Securities Act pursuant to which an issuer may offer and sell an unlimited amount of securities, provided that offers are made without the use of general solicitation or general advertising and sales are made only to accredited investors and up to 35 non-accredited investors who meet an investment sophistication standard.[50] Rule 506(c) of Regulation D provides an exemption without any limitation on offering amount pursuant to which offers may be made through general solicitation or general advertising, so long as the purchasers in the offering are limited to accredited investors and the issuer takes reasonable steps to verify their accredited investor status.[51] The accredited investor definition, which is found in Rule 501(a), is a cornerstone of Regulation D. It also plays an important role in other federal and state securities law contexts.[52]

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[48] Revision of Certain Exemptions From Registration for Transactions Involving Limited Offers and Sales, Release No. 33-6389 (Mar. 8, 1982) [47 FR 11251 (Mar. 16, 1982)] ("Regulation D 1982 Adopting Release").

[49] Rules 500 through 503 of Regulation D contain the notes, definitions, terms, and conditions that apply generally throughout Regulation D. The exemptions and safe harbor of Regulation D are set forth in Rule 504, Rule 506(b), and Rule 506(c). Rule 507 of Regulation D is a provision that disqualifies issuers under certain circumstances from relying on Regulation D for failure to file a notice of sales on Form D. Rule 508 of Regulation D provides that certain insignificant deviations from a term, condition, or requirement of Regulation D will not necessarily result in the loss of a Regulation D exemption.

[50] *See* 17 CFR 230.506(b)(2)(ii) ("Each purchaser who is not an accredited investor either alone or with his purchaser representative(s) has such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment, or the issuer reasonably believes immediately prior to making any sale that such purchaser comes within this description.").

[51] 17 CFR 230.506(c). The Commission adopted Rule 506(c) in 2013 to implement Section 201(a) of the Jumpstart Our Business Startups Act ("JOBS Act"). Pub L. No. 112-106, 126 Stat. 306 (2012). *See* Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings, Release No. 33-9415 (Jul. 10, 2013) [78 FR 44771 (Jul. 24, 2013)].

[52] *See* Section V for a discussion of certain implications of the accredited investor definition under federal and state securities laws.

The current accredited investor definition provides that natural persons and entities that come within, or that the issuer reasonably believes comes within, any of eight enumerated categories at the time of the sale of the securities is an accredited investor. Natural persons may qualify as accredited investors based on the following criteria:

- Individuals who have a net worth exceeding $1 million (excluding the value of the individual's primary residence), either alone or with their spouses;[53]
- Individuals who had an income in excess of $200,000 in each of the two most recent years, or joint income with the individual's spouse in excess of $300,000 in each of those years, and have a reasonable expectation of reaching the same income level in the current year;[54] and
- Directors, executive officers, and general partners of the issuer or of a general partner of the issuer.[55]

Some entities may qualify as accredited investors based on their status alone. These entities include:

- Banks, savings and loan associations, brokers or dealers registered pursuant to Section 15 of the Exchange Act, insurance companies, small business investment companies, investment companies registered under the Investment Company Act, or business development companies as defined in Section 2(a)(48) of that Act;[56]

[53] Rule 501(a)(5).

[54] Rule 501(a)(6).

[55] Rule 501(a)(4).

[56] Rule 501(a)(1).

- Private business development companies as defined in Section 202(a)(22) of the Advisers Act;[57] and
- Entities in which all of the equity owners are accredited investors.[58]

Other entities may qualify as accredited investors based on a combination of their status and the amount of their total assets. These entities include:

- Tax exempt charitable organizations, corporations, Massachusetts or similar business trusts, or partnerships, not formed for the specific purpose of acquiring the securities offered, with total assets in excess of $5 million;[59]
- Plans established and maintained by a state, its political subdivisions, or any agency or instrumentality of a state or its political subdivisions, for the benefit of its employees, if such plan has total assets in excess of $5 million;[60]
- Employee benefit plans (within the meaning of the Employee Retirement Income Security Act) if a bank, savings and loan association, insurance company, or registered investment adviser makes the investment decisions, or if the plan has total assets in excess of $5 million;[61] and
- Trusts with total assets in excess of $5 million, not formed for the specific purpose of acquiring the securities offered, the purchases of which are directed by a person who meets the legal standard of having sufficient knowledge and

[57] Rule 501(a)(2).

[58] Rule 501(a)(8).

[59] Rule 501(a)(3).

[60] Rule 501(a)(1).

[61] Rule 501(a)(1).

experience in financial and business matters to be capable of evaluating the merits and risks of the prospective investment.[62]

The Commission has amended the accredited investor definition on three occasions since the adoption of Regulation D in 1982.[63] First, in 1988, the Commission expanded the definition to include additional types of entities,[64] added a joint income test for natural persons, and eliminated a standard under which a person could qualify as an accredited investor based on the purchase of $150,000 of the securities being offered when the purchase price did not exceed 20% of the person's net worth.[65] Second, in 1989, the Commission amended the definition to include plans established and maintained by state governments and their political subdivisions, as well as their agencies and instrumentalities, for the benefit of their employees if the plans have total assets in excess of $5 million.[66] Third, in 2011, to implement the requirements of Section 413(a) of the Dodd-Frank Act, the Commission amended the $1 million net worth standard for natural persons to exclude the value of the investor's primary residence.[67]

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[62] Rule 501(a)(7).

[63] In addition, in 2007, the Commission proposed but did not adopt a number of changes to the accredited investor definition, which would have, among other things, added an alternative "investments-owned" standard, established a mechanism to adjust the dollar-amount thresholds to reflect inflation, and added several categories of permitted entities to the list of accredited investors. *See* 2007 Proposing Release. In 2013, the Commission requested comment on the accredited investor definition in connection with proposed amendments to Regulation D and Form D. Amendments to Regulation D, Form D and Rule 156, Release No. 33-9416 (July 10, 2013) [78 FR 44806 (July 24, 2013)].

[64] The types of institutional investors added were savings and loan associations and other institutions specified in Section 3(a)(5)(A) of the Securities Act (including credit unions), broker-dealers, certain trusts, partnerships, and corporations.

[65] Regulation D Revisions, Release No. 33-6758 (Mar. 3, 1988) [53 FR 7866 (Mar. 10, 1988)] ("Regulation D 1988 Adopting Release").

[66] Regulation D, Release No. 33-6825 (Mar. 15, 1989) [54 FR 11369 (Mar. 20, 1989)] ("Regulation D 1989 Adopting Release").

[67] Net Worth Standard for Accredited Investors, Release No. 33-9287 (Dec. 21, 2011) [76 FR .81793 (Dec. 29, 2011)] ("Regulation D 2011 Adopting Release").

Although the current accredited investor definition uses wealth—in the form of a certain level of income, net worth, or assets—as a proxy for financial sophistication, we do not believe wealth should be the sole means of establishing financial sophistication for purposes of the accredited investor definition. Accordingly, the proposed amendments would create new categories of individuals and entities that would qualify as accredited investors irrespective of their wealth, on the basis that such investors have the requisite ability to assess an investment opportunity. We discuss these and other proposed amendments to the accredited investor definition in detail below.

B. Adding Categories of Natural Persons Who Qualify as Accredited Investors

We are proposing to add two new categories in the accredited investor definition for natural persons (1) who hold certain professional certifications or designations or other credentials, or (2) who are "knowledgeable employees" of a private fund and are investing in the private fund. With the exception of directors, executive officers, and general partners of the issuer, the current accredited investor definition uses only the financial measures of income and net worth as proxies for a natural person's financial sophistication. The proposed new categories would apply additional markers of financial sophistication for natural persons based on professional knowledge and experience.

1. Professional Certifications and Designations and Other Credentials

We propose to add a category for natural persons to qualify as accredited investors based on certain professional certifications and designations or other credentials that demonstrate an individual's background and understanding in the areas of securities

and investing.[68] We believe that this approach would provide appropriate alternative means of assessing an investor's need for the protections of registration under the Securities Act. We recognize that investors holding such certifications, designations and credentials may not meet the current financial thresholds in the accredited investor definition, and therefore the impact of investment losses on such investors could be significant. Nevertheless, we believe that the concept of financial sophistication encompasses not only an ability to analyze the risks and rewards of an investment but also the capacity to allocate investments in a way to mitigate or avoid risks of unsustainable loss. Adding this new category of individual accredited investors may potentially expand the pool of investors eligible to participate in, and provide capital to, the Regulation D market. As discussed below, we also believe that this standard in some cases could reduce compliance burdens for issuers by providing an alternative basis for qualification that issuers may be able to assess more easily than the current net worth or annual income standards.

The 2015 Staff Report included a staff recommendation that the Commission permit individuals with certain professional credentials to qualify as accredited investors. Commenters who expressed a view about this recommendation generally supported the recommendation.[69] Several commenters stated that qualifying credentials should include

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[68] This proposal is limited to natural persons seeking to qualify as accredited investors on their own behalf, and any discussion in the release of professional certifications, designations, and other credentials has no applicability in the context of that individual making investment recommendations to others as a financial professional.

[69] *See*, *e.g.*, letter from Consumer Federation of America and Americans for Financial Reform dated April 27, 2016 ("CFA/AFR Letter"); letter from Dar'shun Kendrick, Kendrick Law Practice dated May 1, 2016 ("D. Kendrick Letter"); letter from National Small Business Association dated March 29, 2016 ("NSBA Letter"); letter from North American Securities Administrators Association ("NASAA") dated May 25, 2016 ("2016 NASAA Letter"); letter from Kyle Beagle dated January 13, 2016 ("K. Beagle Letter"); letter from Ava Badiee dated May 10, 2016; letter from Chase R. Morello dated January 13, 2016; letter from

one or more of the following: passing the Series 7, Series 65, Series 66, or Series 82 examinations, being a certified public accountant (CPA), certified financial analyst (CFA), certified management accountant (CMA), investment adviser representative or registered representative (RR); having a Masters of Business Administration degree (MBA) from an accredited educational institution or having a certified investment management analyst (CIMA) certification; or having been in the securities industry as a broker, lawyer, or accountant.[70] Other commenters expressed more general views about the sophistication necessary to qualify as an accredited investor.[71]

Keith J. Johnson dated Mar. 6, 2016; letter from Cornell Securities Law Clinic dated April 30, 2016 ("Cornell Law Clinic Letter"); letter from Investment Management Consultants Association dated March 29, 2016 ("IMCA Letter"); letter from Anonymous Investment Banker dated April 13, 2016; letter from Leonard A. Grover, dated June 13, 2016 ("2016 L. Grover Letter"); letter from The TAN2000 International Regulatory Corporation dated December 10, 2016 ("TAN2000 Letter"); letter from Jeff Carlsen dated January 17, 2017 ("J. Carlsen Letter"); letter from Managed Funds Association dated June 16, 2016 ("MFA-1 Letter"); letter from Managed Funds Association dated May 18, 2017 ("MFA-2 Letter"); letter from Mark R. Maisonneuve dated April 26, 2017 ("M. Maisonneuve Letter"); and letter from Crowdfund Intermediary Regulatory Advocates dated January 14, 2016 ("CFIRA Letter"). Some of these commenters supported the recommendation with additional limitations and conditions such as a minimum amount of professional experience or investment limits. *See*, *e.g.*, Beagle Letter; D. Kendrick Letter; Cornell Law Clinic Letter; 2016 NASAA Letter; and TAN2000 Letter.

[70] *See*, *e.g.*, CFA/AFR Letter ("…the Series 7, Series 65, and Series 82 examinations likely 'provide demonstrable evidence of relevant investor sophistication because of the subject matter their examinations cover'"); 2016 NASAA Letter (recommending qualifying credentials to include passing the Series 7, Series 65, or Series 66, provided that there is also a requisite minimum amount of professional experience); MFA-1 Letter and MFA-2 Letter (recommending qualifying credentials would include being a CPA or CFA or having a MBA from an accredited educational institution); M. Maisonneuve Letter (recommending qualifying credentials would include being a CFA); IMCA Letter (recommending qualifying credentials would include having a CIMA certification); CFIRA Letter (recommending qualifying credentials would include being a CPA, CFA, CMA, registered investment adviser, RR or securities attorney); and D. Kendrick Letter (recommending qualifying credentials would include having been in the securities industry as a broker, lawyer, or accountant).

[71] *See*, *e.g.*, NSBA Letter ("…if someone is sophisticated enough to advise others on investing in these types of offerings, for example, they should themselves be qualified to invest in them"); Cornell Law Clinic Letter (credentials required should be substantially high to cause financial sophistication to make up for the loss in ability to sustain financial losses); 2016 L. Grover Letter (experts in industries historically passed over by angel investors should be allowed to qualify as accredited investors); and J. Carlsen Letter (individuals with business-related college degrees).

Several recent advisory committee recommendations similarly have supported expanding the criteria for natural persons to qualify as accredited investors. In 2014, the Investor Advisory Committee recommended that the Commission revise the accredited investor definition to enable individuals to qualify as accredited investors based on their "financial sophistication."[72] In 2015, the Advisory Committee on Small and Emerging Companies recommended including in the accredited investor definition those investors who meet a "sophistication test," regardless of income or net worth.[73] In 2016, the Advisory Committee on Small and Emerging Companies recommended, among other things, that the Commission expand the pool of accredited investors to include individuals who have passed examinations that test their knowledge and understanding in the areas of securities and investing, including the Series 7, Series 65, Series 82, and CFA Examinations and equivalent examinations.[74] In October 2017, the U.S. Department of the Treasury issued a report that includes recommendations on amending the accredited investor definition with the objective of expanding the eligible pool of sophisticated investors to financial professionals, such as registered representatives and investment adviser representatives, who generally are considered qualified to recommend Regulation D investments to others.[75] In addition, the 2016, 2017, and 2018 Small Business Forum Reports included a recommendation that the Commission expand the

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[72] 2014 Investor Advisory Committee Recommendation.

[73] 2015 ACSEC Recommendations.

[74] 2016 ACSEC Recommendations.

[75] A Financial System That Creates Economic Opportunities Capital Markets, U.S. Dept. of the Treasury (Oct. 2017) ("2017 Treasury Report"), *available at* https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-Capital-Markets-FINAL-FINALpdf, at p. 44. Some registered representatives may hold limited licenses that preclude them from recommending Regulation D investments to others.

categories of qualification for accredited investor status based on various types of sophistication, such as education, experience, or training, including, among other things, persons holding FINRA licenses or CPA or CFA designations. The 2019 Small Business Forum Report included a recommendation that the Commission revise the accredited investor definition for natural persons to add a sophistication test as a way to qualify in addition to the income and net worth thresholds in the definition.[76]

The Concept Release requested comment on the use of additional sophistication measures other than income or net worth to permit natural persons to qualify as accredited investors. Table 1 below provides an overview of the feedback provided by Concept Release commenters on this topic.

Table 1: Responses to requests for comment on additional sophistication tests in the accredited investor definition

Responses from Commenters
- Many commenters supported adding a sophistication-based category to the accredited investor definition.[77] Of those commenters:

[76] *See* the 2019 Small Business Forum Report at 8.

[77] *See* K. Sonlin Letter; AOIP Letter; letter from Jor Law Dated July 10, 2019 ("J. Law Letter"); letter from Leonard A. Grover dated July 10, 2019 ("2019 L. Grover Letter"); letter from Broadmark Capital LLC dated July 29, 2019 ("Broadmark Capital Letter"); C. Uchill Letter; letter from Steven Marshall dated August 18, 2019 ("S. Marshall Letter"); J. LaBerge Letter; IWI Letter; Wefunder Letter; HFA Letter; ACA Letter; Funding Circle Letter; letter from Joe Wallin et al. dated September 23, 2019 ("J. Wallin Letter"); letter from G. Philip Rutledge dated September 24, 2019 ("P. Rutledge Letter"); letter from SeedInvest dated September 24, 2019 ("SeedInvest Letter"); letter from Republic dated September 24, 2019 ("Republic Letter"); CFA Institute Letter; EquityZen Letter; Iownit Letter; letter from David R. Burton dated September 24, 2019 ("D. Burton Letter"); CoinList Letter; 2019 SBIA Letter; letter from AngelList Advisors, LLC dated September 25, 2019 ("AngelList Letter"); letter from William F. Galvin, Secretary of the Commonwealth of Massachusetts dated September 24, 2019 ("MA Secretary Letter"); Davis Polk Letter; letter from Crystal World Holdings and New Sports Economy Institute dated September 24, 2019 ("CWH and NSEI Letter"); H. Konings et al. Letter; letter from Crowdfund Capital Advisors dated September 24, 2019 ("CCA Letter"); SIFMA Letter; CCMC Letter; ACG Letter; IPA Letter; ADISA Letter; letter from Carta dated September 24, 2019 ("Carta Letter"); McCarter & English Letter; letter from Jade Barker dated September 24, 2019 ("J. Barker Letter"); J. Schocken Letter; Artivest Letter; J. Tapp Letter; letter from Cody Snyder dated September 11, 2019 ("C. Snyder Letter"); Bridgeport Letter; MLA Letter; J. Thomas Letter; letter from Kirk McGregor and Samarth Sandeep dated September 24, 2019

Responses from Commenters

- Several commenters supported a sophistication category based on passing certain FINRA-administered examinations.[78]
- Several commenters supported a sophistication category based on obtaining a Chartered Financial Analyst certification.[79]
- Two commenters supported a sophistication category based on obtaining a Certified Financial Planner certification.[80]
- Several commenters supported the use of an accredited investor examination.[81]
- One commenter believed insufficient demand existed for an accredited investor examination.[82]
- Several commenters supported the use of educational experience more generally.[83]

("McGregor and Sandeep Letter"); CfPA Letter; A. Ceja Letter; ABA Fed. Reg. of Sec. Comm. Letter; Sec. Reg. Comm. of N.Y.St. B.A. Letter; letter from Leyline Corporation dated October 18, 2019 ("Leyline Letter"); letter from Joey Jones dated October 29, 2019 ("J. Jones Letter"); letter from CrowdCheck dated October 30, 2019 ("CrowdCheck Letter"); and Recommendation of the SEC Small Business Capital Formation Advisory Committee regarding the accredited investor definition (Dec. 11, 2019), (the "2019 Advisory Committee Recommendation"), *available at* https://www.sec.gov/spotlight/sbcfac/recommendation-accredited-investor.pdf.

[78] *See* 2019 L. Grover Letter; C. Uchill Letter; Wefunder Letter; ACA Letter; P. Rutledge Letter; SeedInvest Letter; Republic Letter; EquityZen Letter; D. Burton Letter; CoinList Letter; Davis Polk Letter; H. Konings et al. Letter; ACG Letter; IPA Letter; ADISA Letter; McCarter & English Letter; Artivest Letter; CfPA Letter; Sec. Reg. Comm. of N.Y.St. B.A. Letter; Leyline Letter; J. Jones Letter; and CrowdCheck Letter.

[79] *See* J. Law Letter; SeedInvest Letter; Republic Letter; EquityZen Letter; D. Burton Letter; CoinList Letter; Davis Polk Letter; CWH and NSEI Letter; SIFMA Letter; ACG Letter; IPA Letter; Artivest Letter; CfPA Letter; and CrowdCheck Letter.

[80] *See* D. Burton Letter and CoinList Letter.

[81] *See* J. Tapp Letter; J. Law Letter; 2019 L. Grover Letter; C. Uchill Letter; C. Snyder Letter; IWI Letter; Bridgeport Letter; HFA Letter; ACA Letter; Funding Circle Letter; MLA Letter; J. Wallin Letter; P. Rutledge Letter; SeedInvest Letter; Republic Letter; D. Burton Letter; 2019 SBIA Letter; CWH and NSEI Letter; CCMC Letter; ACG Letter; J. Thomas Letter; Carta Letter; McGregor and Sandeep Letter; CfPA Letter; ABA Fed. Reg. of Sec. Comm. Letter; J. Jones Letter; CrowdCheck Letter; and the 2019 Advisory Committee Recommendation.

[82] *See* Consumer Federation Letter.

[83] *See* K. Sonlin Letter; Broadmark Capital Letter; C. Uchill Letter; S. Marshall Letter; J. LaBerge Letter; Wefunder Letter; HFA Letter; ACA Letter; SeedInvest Letter; Republic Letter; EquityZen Letter; D. Burton Letter; CoinList Letter; CWH and NSEI Letter; H. Konings et al. Letter; CCA Letter; SIFMA Letter; CCMC Letter; IPA Letter; ADISA Letter; McCarter & English Letter; J. Barker Letter; Artivest Letter; CfPA Letter; A. Ceja Letter; ABA Fed. Reg. of Sec. Comm. Letter; and the 2019 Advisory Committee Recommendation.

Responses from Commenters
- A few other commenters expressed concern about adding sophistication -based categories to the definition.[84]

Having considered this feedback, we believe that certain professional certifications and designations or other credentials can indicate an appropriate level of financial sophistication that renders these investors less in need of the protections of registration under the Securities Act. Indeed, relying solely upon financial thresholds may unduly restrict access to investment opportunities for individuals whose knowledge and experience render them capable of evaluating the merits and risks of a prospective investment—and therefore fending for themselves—in a private offering, irrespective of their personal wealth. Accordingly, and consistent with suggestions from a broad range of commenters, we are proposing to amend the rule to include natural persons holding one or more professional certifications or designations or other credentials issued by an accredited educational institution that the Commission designates from time to time as meeting specified criteria. In addition, where applicable, an investor would need to maintain these certifications, designations, or credentials in good standing in order to qualify for accredited investor status.

The Commission's designation of certifications, designations, or credentials would be based upon its consideration of all the facts pertaining to a particular certification, designation, or credential. The proposed amendment would provide the following non-exclusive list of attributes that the Commission would consider in

[84] *See*, *e.g.*, Consumer Federation Letter and PIABA Letter.

determining which professional certifications and designations or other credentials qualify for accredited investor status:

- the certification, designation, or credential arises out of an examination or series of examinations administered by a self-regulatory organization or other industry body or is issued by an accredited educational institution;
- the examination or series of examinations is designed to reliably and validly demonstrate an individual's comprehension and sophistication in the areas of securities and investing;
- persons obtaining such certification, designation, or credential can reasonably be expected to have sufficient knowledge and experience in financial and business matters to evaluate the merits and risks of a prospective investment; and
- an indication that an individual holds the certification or designation is made publicly available by the relevant self-regulatory organization or other industry body.

Professional certifications and designations or other credentials meeting these proposed criteria would be designated as qualifying for accredited investor status by means of a Commission order. We anticipate that the Commission generally would provide public notice and an opportunity for public comment before issuance of such an order. To assist members of the public, the professional certifications and designations or other credentials recognized by the Commission as satisfying the above criteria would be posted on the Commission's website.

We recognize that professional certifications and designations or credentials may evolve with changes in the market and industry practices. The proposed approach would

provide the Commission with flexibility to reevaluate previously designated certifications, designations, or credentials if they change over time, and also to designate other certifications, designations, or credentials if new certifications, designations or credentials develop that meet the specified criteria.

We preliminarily expect that the following certifications or designations would be included in an initial Commission order accompanying the final rule, if adopted:

- **Licensed General Securities Representative (Series 7).** The Series 7 license qualifies a candidate "for the solicitation, purchase, and/or sale of all securities products, including corporate securities, municipal securities, municipal fund securities, options, direct participation programs, investment company products, and variable contracts."[85] FINRA developed and administers the Series 7 examination. An individual must be associated with a FINRA member firm or other applicable self-regulatory organization member firm to be eligible to take the exam and be granted a license.[86]
- **Licensed Investment Adviser Representative (Series 65).** The Series 65 Uniform Investment Adviser Law Examination is designed to qualify candidates as investment adviser representatives and covers topics necessary for adviser representatives to understand to provide investment advice to retail advisory clients.[87] NASAA developed the Series 65 examination, and FINRA administers it. An individual does not need to be sponsored by a member firm to take the

[85] https://www.finra.org/registration-exams-ce/qualification-exams/series7.

[86] FINRA Rule 1210.03. Candidates must also pass the Securities Industry Essentials (SIE) examination to obtain the General Securities Representative designation.

[87] https://www.nasaa.org/exams/study-guides/series-65-study-guide/.

exam, and successful completion of the exam does not convey the right to transact business prior to being granted a license or registration by a state.[88]

- **Licensed Private Securities Offerings Representative (Series 82).** The Series 82 license qualifies individuals seeking to effect the sales of private securities offerings.[89] The examination focuses on private transactions and is more limited in scope than the Series 7 examination. FINRA developed and administers the Series 82 examination. An individual must be associated with and sponsored by a FINRA member firm or other applicable self-regulatory organization member firm to be eligible to take the exam.[90]

The proposed amendments would enable persons holding designated certifications, designations, or credentials to qualify as accredited investors even when they do not meet the income or net worth standards in the accredited investor definition. We preliminarily believe that individuals who have passed the necessary examinations and received their certifications or designations described above have demonstrated a level of sophistication in the areas of securities and investing such that they may not need the protections of registration under the Securities Act. In this regard, we note that these certifications and designations are required in order to represent or advise others in connection with securities market transactions. One commenter stated that, if an

[88] https://www.nasaa.org/exams/exam-faqs/.

[89] https://www.finra.org/registration-exams-ce/qualification-exams/series82. Candidates must also pass the SIE examination to obtain the Private Securities Offerings Representative designation.

[90] FINRA Rule 1210.03.

individual is "sophisticated enough to advise others on investing in these types of offerings … they should themselves be qualified to invest in them."[91]

The following table sets out an estimate of the number of individuals that may hold the certifications and designations described above:

Table 2: Estimated number of individuals holding specified certifications and designations

Certification/Designation	Number of Individuals
Registered Securities Representative	691,041[92]
State Registered Investment Adviser Representative	17,543[93]

As Table 2 illustrates, if we were to adopt the amendments to the accredited investor definition as proposed and designate professional certifications and designations as qualifying credentials, it may result in a significant increase in the number of individuals that qualify as accredited investors. However, we note that we cannot estimate how many individuals that hold the relevant certifications and designations may already qualify as accredited investors under the current financial thresholds, and therefore we are unable to state with certainty how many individuals would be newly eligible under the proposals. Moreover, for purposes of updating the accredited investor definition, we believe it is less relevant to focus on the number of individuals that would

[91] *See* NSBA Letter.

[92] As of December 2018. Of this number, 334,860 individuals were registered only as broker-dealers, 294,684 were dually registered as broker-dealers and investment advisers, and 61,497 were registered only as investment advisers.

Because FINRA-registered representatives can be required to hold multiple professional certifications, this aggregation likely overstates the actual number of individuals that hold a Series 7 or Series 82, and we have no method of estimating the extent of overlap.

[93] As of December 2018.

qualify and more relevant to consider whether the proposed criteria adequately capture the attributes of financial sophistication that is a touchstone of the definition.

We acknowledge that there may be individuals that hold other professional or academic credentials that can demonstrate similar comprehension and sophistication; however, we believe that it is appropriate at this time to tailor this category of credentials and designations to certain ones that directly relate to securities and investing. For example, while commenters have suggested criteria such as college degrees and advanced degrees generally for the accredited investor definition, we are concerned that such a broad approach might not provide a consistent measure of financial sophistication for a variety of reasons, including the range of degrees, the different types of institutions that grant degrees, and the various career paths that degree holders can take.

As proposed, where applicable, an individual would be required to maintain an active certification, designation, or credential[94] to qualify as an accredited investor on this basis but would not be required to practice in fields related to the certification, designation, or credential, except to the extent that continued affiliation with a firm is required to maintain the certification, designation, or credential.[95] We believe that passing the requisite examinations and maintaining an active certification, designation, or license would be sufficient to demonstrate the individual's financial sophistication to invest in Regulation D offerings, even when the individual is not practicing in an area related to the certification or designation. Conversely, an inactive certification,

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[94] To maintain their certifications and designations in good standing, General Securities Representatives and Private Securities Offerings Representatives are subject to continuing education requirements under FINRA rules.

[95] For example, an individual's registration as a general securities representative will lapse two years after the date that his or her employment with a FINRA member has been terminated. *See* FINRA Rule 1210.08.

designation, or license, particularly when the certification or designation has been inactive for an extended period of time, could lessen the validity of the certification or designation as a measure of financial sophistication.

In addition, because issuers must take reasonable steps to verify whether an investor in a Rule 506(c) offering is an accredited investor,[96] readily available information on whether an individual actively holds a particular certification or designation would be useful. For example, issuers and other market participants may obtain registration and licensing information about registered representatives and investment adviser representatives through FINRA's BrokerCheck[97] or the Commission's Investment Adviser Public Disclosure database.[98] For this reason, we are proposing to include, as one of the criteria to be considered by the Commission in recognizing qualifying professional credentials, the public availability of information listing the individuals who hold the relevant certifications or designations.

Request for Comment

1. Are professional certifications and designations or other credentials an appropriate standard for determining whether a natural person is an accredited investor? Do the types of certifications and designations that the Commission is considering indicate that an investor has the requisite level of financial sophistication and abilities to render the protections of the Securities Act unnecessary?

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[96] *See supra* note 51.

[97] https://brokercheck.finra.org/.

[98] https://www.adviserinfo.sec.gov/IAPD/Default.aspx.

2. Are the professional certifications and designations we preliminarily expect to designate as qualifying credentials in an initial Commission order accompanying the final rule appropriate to recognize for this purpose? Should we include a credential from an accredited educational institution, such as an MBA, in such initial order?

3. Should we consider other certifications, designations, or credentials as a means for individuals to qualify as accredited investors? If so, which ones should we consider? For example, there are several FINRA Representative-level and Principal-level exams, as well as FINRA-administered NASAA exams, Municipal Securities Rulemaking Body exams, and National Futures Association exams, that cover a broad range of subjects relating to the markets, the securities industry and its regulatory structure.[99] Should we consider any other FINRA-developed examinations or FINRA–administered examinations not discussed in this release? Should we consider designating any professional certifications or designations or credentials issued outside of the United States? Should we consider other certifications and designations administered by private organizations, such as the CFA Institute and the Certified Financial Planner Board of Standards? Does the fact that these private organizations are not subject to Commission oversight or regulation raise concerns with respect to the inclusion of certifications or designations such as the CFA Charter or the CFP Certification as a means of accredited investor qualification?

[99] *See* https://www.finra.org/registration-exams-ce/qualification-exams.

4. A FINRA introductory-level examination, the "Securities Industry Essentials" (SIE) examination, is a co-requisite to the Series 7 and Series 82 examinations and assesses a candidate's knowledge of basic securities industry information.[100] The SIE examination is open to any individual aged 18 or over, and association with a firm is not required. Passing the SIE examination alone does not qualify an individual for registration with a FINRA member firm or to engage in securities business. We have not included the SIE examination among those we expect initially to designate as qualifying credentials because the SIE examination is relatively new and evaluates introductory-level comprehension of the securities industry. Should we consider the SIE examination as a means for individuals to qualify as accredited investors? Should we consider the SIE examination, in addition to the completion of an investing-related course at an accredited college or university, as a means for individuals to qualify as accredited investors?

5. FINRA's Series 86 and 87 examinations assess the ability of an entry-level registered representative to perform their job as a research analyst.[101] As with the Series 7 and Series 82 examinations, an individual must be associated with and sponsored by a FINRA member firm or other applicable self-regulatory organization member firm to be eligible to take the Series 86 and 87 examinations. The SIE examination is also co-requisite to the Series 86 and 87 examinations. Should we consider the Series 86 and 87 examinations as a means for individuals to qualify as accredited investors?

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[100] https://www.finra.org/registration-exams-ce/qualification-exams/securities-industry-essentials-exam.

[101] https://www.finra.org/registration-exams-ce/qualification-exams/series86-87.

6. The Series 66 NASAA Uniform Combined State Law Examination (Series 66) is designed to qualify candidates as investment adviser representatives and as broker-dealer representatives.[102] NASAA developed the Series 66 examination, and FINRA administers it. An individual does not need to be sponsored by a member firm to take the exam,[103] and successful completion of the exam does not convey the right to transact business prior to being granted a license or registration by a state. Should we consider the Series 66 examination and registration as an investment adviser representative as a means for individuals to qualify as accredited investors?

7. Several types of certifications and designations, including the Series 7, Series 82, Series 86, and 87 licenses, require that an individual be sponsored by a FINRA member firm to take the exam. Other certifications and designations, including the Series 65, Series 66, and the SIE, do not have such a requirement. With respect to certifications and designations for which an individual does not need to be sponsored by a member firm, should we consider imposing a waiting period following an individual's attainment of the credential or designation before the individual can invest in an offering as an accredited investor? If so, would a 30-day waiting period, or some other period of time be appropriate?

8. Should we, as proposed, designate certain certifications, designations, or credentials as qualifying credentials by order, or should we instead include

[102] https://www.finra.org/registration-exams-ce/qualification-exams/series66.

[103] Though the Series 66 examination has no pre-requisites, in order to register as an investment adviser representative based on passing the Series 66 examination, an individual must also have passed the FINRA Series 7 examination.

specific certifications, designations, or credentials in the rule itself? The proposed provision specifies various attributes that the Commission would consider in making this determination. Is the proposed list of attributes appropriate or are there other criteria that we should consider in determining whether certain professional certifications or designations or other credentials should be recognized as qualifying for accredited investor status? One proposed attribute that may be considered is that an indication that an individual holds the certification or designation is made publicly available by the relevant self-regulatory organization or other industry body. Would such a publicly available indication be necessary if the individual can demonstrate to the issuer that he or she has actually obtained the certification, or designation?

9. Should the individuals who obtain the designated professional credentials be required to maintain these certifications or designations in good standing in order to qualify as accredited investors, as proposed? Should they also be required to practice in the fields related to the certifications or designations, or to have practiced for a minimum number of years? Certain of the professional certifications or designations we are considering require an individual to be associated with a FINRA member firm or other applicable self-regulatory organization member firm, or require a certain amount of work experience in order to qualify for the certification or designation, while others do not. Is it appropriate to recognize professional certifications or designations that require employment at certain firms, state registration or licensure, or a minimum amount of work experience, as proposed? If work experience is a requirement for a

certification but not a prerequisite to taking the relevant exam, should successful completion of the exam be sufficient to qualify for accredited investor status, instead of requiring certification?

10. Under the proposed approach, individuals with certain certifications, designations, or credentials would qualify as accredited investors regardless of their net worth or income. While having such a certification, designation, or credential may be a measure of financial sophistication, which should encompass the investor's capacity to allocate their investments in a way to mitigate or avoid risks of unsustainable loss, the impact of an investment loss on an investor that does not meet the current net worth or income thresholds may be significant. Should we consider additional conditions, such as investment limits, for individuals with these certifications, designations, or credentials who do not meet the income test or net worth test, in order to qualify as accredited investors? If so, what types of investment limits or other conditions should we consider?

11. Should we consider educational backgrounds more generally, such as advanced degrees in certain areas such as law, accounting, business, or finance, as a means for qualifying as an accredited investor? If so, which degrees would be appropriate? Should the individual also be required to demonstrate professional experience in such areas?

12. Should we consider professional experience in areas such as finance and investing, apart from professional certifications and designations, as another means for qualifying for accredited investor status? If so, what factors should we consider in evaluating whether an individual has the capability of evaluating the

merits and risks of a prospective investment based on his or her professional experience? For example, should the focus be on specific types and levels of job experience? Should we consider only professional experience related to the securities industry? If so, would it be appropriate to include only those actively involved in the buying and selling of securities, or should we consider other professionals whose work experience may demonstrate an understanding of the investment process? How should the Commission determine the appropriate level of experience needed in order to qualify as an accredited investor under such a test?

13. Should we consider developing an accredited investor examination as another means for determining investor sophistication? What are the advantages and disadvantages of such an approach? What should be considered in developing and designing such an examination?

14. Should we consider permitting individuals to self-certify that they have the requisite financial sophistication to be an accredited investor as another means for determining investor sophistication?

2. Knowledgeable Employees of Private Funds

We propose to add a category to the accredited investor definition that would enable "knowledgeable employees" of a private fund to qualify as accredited investors for investments in the fund.[104] Private funds, such as hedge funds, venture capital funds,

[104] Rule 3c-5(a)(4) under the Investment Company Act defines a "knowledgeable employee" with respect to a private fund as: (i) an executive officer, director, trustee, general partner, advisory board member, or person serving in a similar capacity, of the private fund or an affiliated management person (as defined in Rule 3c-5(a)(1)) of the private fund; and (ii) an employee of the private fund or an affiliated management person of the private fund (other than an employee performing solely clerical, secretarial or administrative

and private equity funds, are issuers that would be an investment company, as defined in Section 3 of the Investment Company Act, but for the exclusion from the definition of "investment company" in Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act.[105] Private funds generally rely on Section 4(a)(2) and Rule 506 to offer and sell their interests without registration under the Securities Act.

Section 3(c)(1) of the Investment Company Act excludes from the definition of "investment company" any issuer whose outstanding securities (other than short-term paper) are beneficially owned by not more than 100 persons, and which is not making and does not presently propose to make a public offering of its securities. As discussed above, Section 3(c)(7) of the Investment Company Act excludes from the definition of "investment company" any issuer whose outstanding securities are owned exclusively by persons who, at the time of acquisition of such securities, are "qualified purchasers," and which is not making and does not at that time propose to make a public offering of its securities.[106]

Pursuant to Rule 3c-5, "knowledgeable employees" of a private fund may acquire securities issued by the fund without being counted for purposes of Section 3(c)(1)'s 100-

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functions with regard to such company or its investments) who, in connection with his or her regular functions or duties, participates in the investment activities of such private fund, other private funds, or investment companies the investment activities of which are managed by such affiliated management person of the private fund, provided that such employee has been performing such functions and duties for or on behalf of the private fund or the affiliated management person of the private fund, or substantially similar functions or duties for or on behalf of another company for at least 12 months.

[105] 15 U.S.C. 80a-3(c)(1) and (c)(7).

[106] Issuers that rely on Section 3(c)(1) or 3(c)(7) of the Investment Company Act are a subset of pooled investment funds. The definition of "qualified purchaser" in Section 2(a)(51) of the Investment Company Act includes any natural person (including any person who holds a joint, community property, or other similar shared ownership interest in an issuer that is excepted under Section 3(c)(7) of the Investment Company Act with that person's qualified purchaser spouse) who owns not less than $5 million in investments (as defined by the Commission).

investor limit and may invest in a Section 3(c)(7) fund even though they do not meet the definition of "qualified purchaser."[107] This provision permits individuals who participate in a fund's management to invest in the fund as a benefit of employment.[108] However, even though a knowledgeable employee is permitted to invest in a Section 3(c)(7) fund (along with other natural persons that have a high degree of financial sophistication),[109] a knowledgeable employee may not meet the financial thresholds in the accredited investor definition. Therefore, a knowledgeable employee who does not meet the accredited investor definition may be excluded from participating in an offering of the private fund under Rule 506 if the offering is limited to accredited investors.

The 2015 Staff Report included a recommendation that the Commission revise the accredited investor definition to permit knowledgeable employees of sponsors of private funds to qualify as accredited investors for investments in the funds sponsored by their employers, using the definition of the term "knowledgeable employee" in Rule 3c-5(a)(4). In response to the 2015 Staff Report, several commenters expressed support for the recommendation,[110] while one commenter opposed this

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[107] Rule 3c-5(b).

[108] 2015 Staff Report.

[109] Such an employee would be considered a qualified client under Rule 205-3(d)(1)(iii) under the Advisers Act (allowing such funds to offer performance fees).

[110] *See*, *e.g.*, CFA/AFR Letter ("…such individuals 'likely have significant investing experience and sufficient access to the information necessary to make informed decisions about investments in their employer's funds'"); NSBA Letter; Cornell Law Clinic Letter ("Knowledgeable employees of private funds are likely some of the highest levels of financial sophistication among potential investors."); MFA-1 Letter; and MFA-2 Letter ("…such knowledgeable employees have meaningful investing experience and sufficient access to information necessary to make informed investment decisions about the private fund's offerings. In addition, investments by knowledgeable employees are beneficial for private fund investors in that they further align investor interests of adviser employees and fund investors.").

recommendation.[111] In July 2016, the Advisory Committee on Small and Emerging Companies, though not specifically referencing knowledgeable employees, recommended that the Commission explore more generally different ways to permit participation by potential investors with specific industry or issuer knowledge or expertise who would otherwise not qualify for accredited investor status.[112] The 2016, 2017, and 2018 Small Business Forum Reports included a recommendation that the Commission expand the categories of qualification to include, among other things, status as managerial or key employees affiliated with the issuer. In addition, a number of commenters on the Concept Release supported permitting a private fund's knowledgeable employees to invest in the private fund.[113]

We are not able to estimate the number of individuals that would qualify as accredited investors under this proposed amendment to the definition. Using data on private fund statistics compiled by the Commission's Division of Investment Management, we estimate that there were 32,202 private funds as of fourth quarter 2018.[114] However, we lack data on the number of knowledgeable employees per fund. We also cannot estimate how many individuals that meet the definition of "knowledgeable employee" may already qualify as accredited investors under the current financial thresholds.

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[111] *See* 2016 NASAA Letter ("Such an approach could raise suitability issues, may be difficult to verify, and ultimately has a negligible impact in improving capital formation efforts.").

[112] *See* 2016 ACSEC Recommendations.

[113] *See* ACA Letter; Funding Circle Letter; MLA Letter; J. Wallin Letter; P. Rutledge Letter; MFA and AIMA Letter; EquityZen Letter; 2019 SBIA Letter; BlackRock Letter; ACG Letter; letter from Dechert LLP dated September 24, 2019; Artivest Letter; and Sec. Reg. Comm. of N.Y.St. B.A. Letter.

[114] *See* https://www.sec.gov/divisions/investment/private-funds-statistics/private-funds-statistics-2018-q4.pdf.

The proposed new category of accredited investor would be the same in scope as the definition of "knowledgeable employee" in Rule 3c-5(a)(4).[115] It would include, among other persons, trustees and advisory board members, or persons serving in a similar capacity, of a Section 3(c)(1) or 3(c)(7) fund or an affiliated person of the fund that oversees the fund's investments, as well as employees of the private fund or the affiliated person of the fund (other than employees performing solely clerical, secretarial, or administrative functions) who, in connection with the employees' regular functions or duties, have participated in the investment activities of such private fund for at least 12 months.[116] This new category would be similar to the existing category for directors, executive officers, or general partners of the issuer (or directors, executive officers, or general partners of a general partner of the issuer).[117] We believe that such employees, through their knowledge and active participation of the investment activities of the private fund, are likely to be financially sophisticated and capable of fending for themselves in evaluating investments in such private funds.[118] These employees, by virtue of their position with the fund, are presumed to have meaningful investing experience and sufficient access to the information necessary to make informed

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[115] *See* proposed Rule 501(a)(11).

[116] The scope of the term "knowledgeable employee" in Rule 3c-5(a)(4) also includes executive officers, directors, and general partners, or persons servings in a similar capacity, of a Section 3(c)(1) or 3(c)(7) fund or an affiliated person of the fund that oversees the fund's investments. For these persons, the proposed new category for "knowledgeable employees" in the definition of "accredited investor" would overlap with the existing category in Rule 501(a)(4), which encompasses directors, executive officers, and general partners of the issuer, as well as directors, executive officers, and general partners of a general partner of the issuer. A person is determined to be a knowledgeable employee at the time of investment. *See* Rule 3c-5(b)(1).

[117] Rule 501(a)(4).

[118] As is the case under Rule 3c-5(a)(4), the scope of "knowledgeable employees" under this proposed amendment would not include employees who simply obtain information but do not participate in the investment activities of the fund.

investment decisions about the fund's offerings. Allowing these employees to invest in the funds for which they work also may help to align their interests with those of other investors in the fund.

The inclusion of knowledgeable employees in the definition of "accredited investor" would also allow these employees to invest in the private fund without the fund itself losing accredited investor status when the funds have assets of $5 million or less. Under Rule 501(a)(8), private funds with assets of $5 million or less may qualify as accredited investors if all of the fund's equity owners are accredited investors.[119] Unless they qualify as accredited investors, these small private funds could otherwise be excluded from participating in some offerings under Rule 506 that are limited to accredited investors. Amending the accredited investor definition in this manner would allow knowledgeable employees to invest in these small private funds as accredited investors, while permitting the funds to remain eligible to qualify as accredited investors under Rule 501(a)(8).

Request for Comment

15. Should knowledgeable employees of private funds be added to the definition of accredited investor as proposed?

16. Would adding "knowledgeable employees" as a category in the accredited investor definition raise concerns that small private funds could qualify as accredited investors under Rule 501(a)(8) when all or most of its equity owners

[119] A private fund may qualify as an accredited investor if it holds total assets in excess of $5 million and is a corporation, Massachusetts or similar business trust, or partnership, not formed for the specific purpose of acquiring the securities offered. A private fund may also be able to qualify as an accredited investor if it is a trust with total assets in excess of $5 million that was not formed for the specific purpose of acquiring the securities offered, and the purchase is directed by a sophisticated person.

consist of knowledgeable employees? Do small private funds raise different concerns than pooled investment funds such as registered investment companies, business development companies, and small business investment companies that qualify as accredited investors without satisfying any quantitative criteria such as a total assets or investments threshold?

17. Under the proposed definition of "accredited investor," should a knowledgeable employee's accredited investor status be attributed to his or her spouse and/or dependents when making joint investments in private funds? Is the answer to this question the same for a family corporation or similar estate planning vehicle for which the knowledgeable employee is responsible for investment decisions and the source of the funds invested?

18. Should the Commission consider including certain types of employees of a non-fund issuer in the accredited investor definition for purposes of a securities offering by that issuer? If so, what are the job types or categories of employees that should be considered to have the appropriate level of financial sophistication and access to the information necessary to make informed investment decisions about the issuer's offerings? For example, would it be appropriate to consider including officers of an issuer, or employees that serve a particular function such as employees who oversee the issuer's financial reporting or business operations? Similarly, should the Commission consider including other individuals with a familial or similar relationship to an issuer in the definition for purposes of such an issuer's securities offering? If so, how should we determine the appropriate individuals and types of relationships that would be covered by such a provision?

3. Proposed Note to Rule 501(a)(5)

We are proposing to add a note to Rule 501 to clarify that the calculation of "joint net worth" for purposes of Rule 501(a)(5) can be the aggregate net worth of an investor and his or her spouse (or spousal equivalent if "spousal equivalent" is included in Rule 501(a)(5), as proposed), and that the securities being purchased by an investor relying on the joint net worth test of Rule 501(a)(5) need not be purchased jointly.[120]

It does not appear to be necessary, in the accredited investor context, to limit how an investor takes title to securities or how spouses own assets. Owning assets separately may be preferable for estate planning purposes, while owning assets jointly offers a different set of advantages.[121] Moreover, nothing in previous Regulation D releases indicates that the Commission intended the term "joint" in Rule 501(a)(5) to require (1) joint ownership of assets when calculating the net worth of the spouses, or (2) that an investor relying on the joint net worth test acquire the security jointly instead of separately. Furthermore, allowing spouses to own assets in various forms for the purposes of the net worth test is consistent with how the Commission treats spousal ownership of assets in other contexts.[122]

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[120] This proposed note is consistent with an existing staff interpretation. *See* question number 255.11 of Securities Act Rules Compliance and Disclosure Interpretations, *available at* https://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm.

[121] *See* Andrea Coombes, *Separate Assets, Joint Problems* Wall St. J., (Nov. 10, 2013), *available at* https://www.wsj.com/articles/separate-assets-joint-problems-1383947655 (noting that separate ownership may provide certain estate planning advantages and joint ownership may provide certain creditor protections and administrative conveniences).

[122] *See* Investment Company Act Rule 2a51-1, which permits separate ownership, joint ownership, and community property ownership.

Request for Comment

19. Should we add a note to clarify the calculation of "joint net worth" for purposes of Rule 501(a)(5), as proposed?

C. Adding Categories of Entities that Qualify as Accredited Investors

The accredited investor definition includes enumerated categories of entities in paragraphs (1) through (3), (7), and (8) of Rule 501(a).[123] Any entity not covered specifically by one of the enumerated categories is not an accredited investor under the rule. This has resulted in some degree of uncertainty for legal entities of a type similar to, but not precisely the same as, those entities specifically enumerated in Rule 501(a). In addition, federal and state law developments since the adoption of Regulation D have expanded the types of business entities that exist, and relatively recent concepts, such as limited liability companies, suggest that developments in this area are ongoing. Moreover, there are some entities—such as registered investment advisers—that are not currently enumerated in Rule 501(a) but that may exhibit attributes of financial sophistication and an ability to fend for themselves or sustain losses that are similar to those of enumerated entities. In light of these considerations, we believe that an expansion of the types of entities that qualify as accredited investors may reduce uncertainty and legal costs and promote more efficient private capital formation.

1. Registered Investment Advisers

We propose to include in Rule 501(a)(1) investment advisers registered under Section 203 of the Advisers Act[124] and investment advisers registered under the laws of

[123] *See* Section II.A above for a summary of the categories of entities covered by the current rule.

[124] *See* Section 203 of the Investment Advisers Act of 1940 (15 U.S.C. 80b-3).

the various states. Though these entities have not previously been included as accredited investors, we believe it is appropriate to propose including them at this time.

As discussed above, the definition of "accredited person" in former Rule 242 is the antecedent to the current accredited investor definition. Adopted in 1980, Rule 242 was an exemption from registration for sales to an unlimited number of "accredited persons" and to 35 other purchasers.[125] Included as accredited persons were certain institutional investors: banks, insurance companies, certain employee benefit plans, investment companies, and small business investment companies ("SBICs"). Regarding which institutions were to be included in this list, the Commission noted that "[t]he definition of accredited person is similar to provisions found in state securities laws, in the ALI Federal Securities Code, and in proposed legislation,"[126] none of which included registered investment advisers. In adopting Regulation D, the Commission used Rule 242's list of institutional investors, adding only business development companies.[127]

When the Commission amended the definition of accredited investor in 1988 to include savings and loan associations, credit unions, and registered broker-dealers, the Commission stated that there did not appear to be a compelling reason to distinguish these newly included institutions from those that were already treated as accredited investors, noting that most states already treated these new entities as institutional investors.[128]

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[125] *See* Rule 242 Adopting Release at 6363.

[126] *See* Exemption of Limited Offers and Sales by Corporate Issuers, Release No. 33-6121 (September 11, 1979) [44 FR 54258 at 54259 (Sept. 18, 1979)].

[127] *See* Regulation D 1982 Adopting Release.

[128] *See* Regulation D 1988 Adopting Release at 7866, noting that "[m]ost of the states in their institutional investor exemptions already exempt securities offerings to these categories of investors." *See also* footnote

The Uniform Securities Act[129] was amended in 2002, and the definition of institutional investor therein was expanded to include, among others, SEC-registered investment advisers acting for their own accounts.[130] Twenty states have adopted a version of the 2002 Uniform Securities Act.[131] As registered investment advisers are now generally considered to be institutional investors under state law, following the rationale the Commission applied in 1988, we see no compelling reason to distinguish SEC- and state-registered investment advisers from those institutional investors already treated as accredited investors.

We estimate that there are currently approximately 13,400 SEC-registered investment advisers and approximately 17,500 state-registered investment advisers that would be covered by the proposed rule change. We are not able to estimate how many of those SEC- or state-registered investment advisers may meet the $5 million assets test under Rule 501(a)(3) and therefore currently qualify as accredited investors. Because registered investment advisers, like the other entity types listed in Rule 501(a)(1), appear to have the requisite financial sophistication needed to conduct meaningful investment

11 of the Regulation D 1988 Adopting Release, describing Section 402(b)(8) of the Uniform Securities Act which "exempts any offer or sale to a bank, savings institution, trust company, insurance company, investment company as defined in the Investment Company Act of 1940, pension or profit sharing trust, or other financial institution or institutional buyer, or to a broker-dealer, whether the purchaser is acting for itself or in some fiduciary capacity."

[129] The Uniform Securities Act was developed by the National Conference of Commissioners on Uniform State Laws as a model securities regulation statute that the states could choose to use as a basis for their own statutes. *See* https://www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=9b2b8f23-651c-c727-e234-3af8b5ab1b6e&forceDialog=0.

[130] *See* Section 102(11) of the Uniform Securities Act (2002). *See also* Section 202(13) of the Uniform Securities Act (2002) (exempting a sale or offer to sell to an institutional investor from certain registration and filing requirements).

[131] *See* https://www.uniformlaws.org/committees/community-home?CommunityKey=8c3c2581-0fea-4e91-8a50-27eee58da1cf.

analysis, we believe it is appropriate to extend accredited investor status to all SEC- and state-registered investment advisers.

Request for Comment

20. Should SEC- and state-registered investment advisers be added to the list of entities specified in Rule 501(a)(1) and qualify as accredited investors, as proposed? Alternatively, should only SEC-registered investment advisers qualify as accredited investors? If so, why? Should we allow exempt reporting advisers to qualify as accredited investors?[132] If so, should exempt reporting advisers be subject to additional conditions?

2. Rural Business Investment Companies

A rural business investment company ("RBIC") is defined in Section 384A of the Consolidated Farm and Rural Development Act[133] as a company that is approved by the Secretary of Agriculture and that has entered into a participation agreement with the Secretary.[134] RBICs are intended to promote economic development and the creation of wealth and job opportunities in rural areas and among individuals living in such areas.[135]

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[132] An exempt reporting adviser is an investment adviser that qualifies for the exemption from registration under Section 203(l) of the Advisers Act because it is an adviser solely to one or more venture capital funds, or under Rule 203(m)-1 of the Advisers Act because it is an adviser solely to private funds and has assets under management in the United States of less than $150 million. *See* Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers, Investment Advisers Act Release No. 3222 (June 22, 2011) [76 FR 39646 (July 6, 2011)].

[133] 7 U.S.C. 2009cc.

[134] *See* Pub. L. 115-417 (2019). To be eligible to participate as an RBIC, the company must be a newly formed for-profit entity or a newly formed for-profit subsidiary of such an entity, have a management team with experience in community development financing or relevant venture capital financing, and invest in enterprises that will create wealth and job opportunities in rural areas, with an emphasis on smaller enterprises. *See* 7 U.S.C. 2009cc-3(a).

[135] http://www.rd.usda.gov/programs-services/rural-business-investment-program.

Their purpose is similar to the purpose of SBICs, which are intended to increase access to capital for growth stage businesses.[136] Because SBICs and RBICs share the common purpose of promoting capital formation in their respective sectors, advisers to SBICs and RBICs are treated similarly under the Advisers Act in that they have the opportunity to take advantage of expanded exemptions from investment adviser registration.[137] Because of their common purpose, we also believe they should be treated similarly under the Securities Act. SBICs are already accredited investors under Rule 501(a)(1). We therefore propose to include RBICs as accredited investors under Rule 501(a)(1).

Request for Comment

21. Should RBICs be added to the list of entities specified in Rule 501(a)(1) and qualify as accredited investors, as proposed? Is there any reason to treat RBICs differently than SBICs in this regard?

3. Limited Liability Companies

Rule 501(a)(3) sets forth the following types of entities that qualify for accredited investor status if they have total assets in excess of $5 million and were not formed for the specific purpose of acquiring the securities being offered: organizations described in section 501(c)(3) of the Internal Revenue Code, corporations, Massachusetts or similar business trusts, and partnerships.[138] This list does not include limited liability companies,

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[136] https://www.sba.gov/partners/sbics.

[137] Advisers to solely RBICs and advisers to solely SBICs are exempt from investment adviser registration. Advisers Act Sections 203(b)(8) and 203(b)(7), respectively. The venture capital fund adviser exemption deems RBICs and SBICs to be venture capital funds for purposes of the exemption. 15 U.S.C. 80b-3(l). The private fund adviser exemption excludes the assets of RBICs and SBICs from counting towards the $150 million threshold. 15 U.S.C. 80b-3(m).

[138] *See* Rule 501(a)(3).

which have become a widely adopted corporate form since the Commission last updated the accredited investor rules in 1989 to include additional entities.[139]

In 1977, the state of Wyoming was the first state to enact a statute authorizing the creation of a limited liability company.[140] However, more widespread adoption of the limited liability company as a corporate form did not occur until more than a decade later.[141] Indeed, it took until 1996 for all fifty states to enact limited liability company statutes.[142] The slow adoption of the limited liability company as a corporate form may help explain why limited liability companies were not included in the Regulation D 1982 Adopting Release, the Regulation D 1988 Adopting Release, or the Regulation D 1989 Adopting Release, which together expanded Rule 501(a)(3) to include the enumerated list as it exists today.

Given the widespread adoption of the limited liability company as a corporate form, we propose to include limited liability companies in Rule 501(a)(3). The proposed amendment would codify a longstanding staff position that limited liability companies that satisfy the other requirements of the definition are eligible to qualify as accredited investors under Rule 501(a)(3).[143] One commenter responding to the Concept Release

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[139] *See* Regulation D 1989 Adopting Release.

[140] *See* Susan Pace Hamill, "The Story of LLCs: Combining the Best Features of a Flawed Business Tax Structure" in Business Tax Stories: An In-Depth Look at Ten Leading Developments in Corporate and Partnership Taxation (Foundation Press, 2005), *available at* https://www.law.ua.edu/misc/bio/hamill/Chapter%2010--Business%20Tax%20Stories%20(Foundation).pdf

[141] *Id*. at 297 (noting that the State of Florida enacted a limited liability company statute in 1982, but that the next state to adopt a similar statute did not do so until 1990).

[142] *Id*.

[143] *See* Division of Corporation Finance interpretive letter to Wolf, Block, Schorr and Solis-Cohen (Dec. 11, 1996); and question number 255.05 of Securities Act Rules Compliance and Disclosure Interpretations, *available at* https://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm.

supported the inclusion of limited liability companies as accredited investors under Rule 501(a)(3).[144]

Due to a lack of publicly available information about limited liability companies, we are unable to estimate the number of limited liability companies that would qualify as accredited investors under the proposed rule. We believe that limited liability companies that meet the requirements of Rule 501(a)(3), including the assets test, should be considered to have the requisite financial sophistication to qualify as accredited investors. Moreover, we are not aware of abuses or concerns associated with the current treatment of limited liability companies that satisfy the other requirements of the definition as accredited investors that would warrant their exclusion from the definition.

We are aware that some individuals may prefer to make investments through an entity instead of on an individual basis, and we understand that frequently such individuals will opt to use the limited liability company form of organization. In such cases, the limited liability company may not qualify under Rule 501(a)(3) if it was formed for the specific purpose of acquiring the securities being offered, regardless of the amount of assets held by the LLC. However, because Rule 501(a)(8) accredits any entity in which all of the equity owners are accredited investors, a limited liability company formed for this purpose may still qualify as an accredited investor under such rule.[145]

We note that Rule 501(a)(4) includes as an accredited investor any director, executive officer, or general partner of the issuer of the securities being offered or sold.

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[144] *See* MFA and AIMA Letter.

[145] As discussed below in Section II.C.5, we are proposing to add a note to Rule 501(a)(8) that would clarify the application of Rule 501(a)(8) when the equity owner is itself an entity rather than a natural person.

The term "executive officer" is defined in Rule 501(f) as "the president, any vice president in charge of a principal business unit, division or function, as well as any other officer who performs a policy making function, or any other person who performs similar policy making functions for the issuer." We are of the view that a manager of a limited liability company performs a policy making function for the issuer equivalent to that of an executive officer of a corporation under Rule 501(f), and therefore we do not believe it is necessary to amend Rule 501(a)(4) or Rule 501(f) to specifically include managers of limited liability companies. We believe that such managers, through their knowledge and management of the issuer, are likely to be sophisticated financially and capable of fending for themselves in evaluating investments in the limited liability company's securities.

Request for Comment

22. Should limited liability companies be added to the list of entities specified in Rule 501(a)(3), as proposed?

23. If limited liability companies are listed in Rule 501(a)(3), should we further amend our rules to specifically include managers of limited liability companies as executive officers under Rule 501(f)? Instead of all managers, should we limit this provision to managing members, which would preclude third-party managers from being considered executive officers under Rule 501(f)? Alternatively, should we include managers of limited liability companies in Rule 501(a)(4)'s list of insiders who may qualify as accredited investors?

4. Other Entities Meeting an Investments-Owned Test

In addition to limited liability companies, other types of entities, such as Indian tribes, labor unions, governmental bodies and funds, and entities organized under the laws of a foreign country, are not specifically listed in the accredited investor definition.

In the 2015 Staff Report, the Commission staff recommended that the Commission "consider modifying the definition to permit any entity with investments in excess of $5 million, and not formed for the specific purpose of investing in the securities offered, to qualify as an accredited investor."[146] The staff noted that a definition of investments "based on the definition of investments in Rule 2a51-1(b) would promote consistency across securities laws and provide a predictable framework."[147] Responses were mixed, with several commenters supporting the recommendation[148] and other commenters opposing it.[149]

The Concept Release requested comment on whether the Commission should revise the definition to expand the types of entities that may qualify as accredited investors, and if so, what types of entities should be included. Several commenters

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[146] *See* 2015 Staff Report at 92.

[147] *Id.*

[148] *See*, *e.g.*, letter from the Small Business Investor Alliance dated March 7, 2016 ("2016 SBIA Letter"); NSBA Letter; and 2016 NASAA Letter ("An investments test is a better gauge of financial sophistication than simply analyzing net worth or income").

[149] *See*, *e.g.*, K. Beagle Letter; Cornell Law Clinic Letter; and Reardon Letter.

supported expanding the definition to include specific additional entity types, including Indian tribes[150] and certain state and local governmental entities.[151]

The Concept Release also requested comment on whether the Commission should replace all $5-million-total-assets thresholds with $5-million-total-investments thresholds, while including all entities instead of enumerating certain entities. While one commenter opposed replacing the asset test with an investments test,[152] several commenters supported allowing all entities owning $5 million in investments to qualify as an accredited investor.[153]

In response to these comments and recommendations, we are proposing to add a new category in the accredited investor definition for any entity owning investments in excess of $5 million that is not formed for the specific purpose of acquiring the securities being offered.[154] As shown by the emergence of limited liability companies, it is possible that an entirely new corporate form could gain acceptance but not come within the scope of Rule 501(a). Proposed Rule 501(a)(9) is intended to capture all existing entity forms

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[150] *See* CrowdCheck Letter; NAFOA Letter; G. Clarkson Letter; J. Wallin Letter; REDCO Letter; and IMDG Letter. The NAFOA Letter, which the G. Clarkson Letter, J. Wallin Letter, REDCO Letter, and IMDG Letter all supported, recommended revising Rule 501(a)(1) to include "any plan established and maintained by a tribal government, its political subdivisions, or any agency or instrumentality of a tribal government or its political subdivisions, for the benefit of its citizens (members), if such plan has total assets in excess of $5,000,000 in non-trust assets," with the term "non-trust asset" defined as "an asset that is under the direct control of a tribe or tribal entity, and which is not held in trust by the United States for the benefit of the tribe." In addition, the 2019 Small Business Forum Report included a recommendation that the Commission revise the accredited investor definition to provide tribal governments parity with state governments.

[151] *See* CMTA Letter (supporting the inclusion of state and local governments having $100 million of assets under management as accredited investors).

[152] *See* IPA Letter (asserting that such a change would "unduly [shrink] the current pool of eligible investors").

[153] *See* CMTA Letter; EquityZen Letter; ICI Letter; BlackRock Letter; Artivest Letter; ABA Fed. Reg. of Sec. Comm. Letter; Sec. Reg. Comm. of N.Y.St. B.A. Letter; and letter from PFM Asset Management LLC dated December 6, 2019 ("PFM Letter").

[154] Proposed Rule 501(a)(9).

not already included within Rule 501(a), such as Indian tribes and governmental bodies, as well as those entity types that may be created in the future.

We believe requiring $5 million in investments instead of assets for this "catch-all" category of entities may better demonstrate that the investor has experience in investing and is therefore more likely to have a level of financial sophistication similar to that of other institutional accredited investors. For example, certain types of entities that would be covered by the proposed amendment, such as governmental entities, may have $5 million in non-financial assets such as land, buildings, and vehicles, but not have any investment experience. With respect to this new category of entities, we believe that an investments test may be more likely than an assets-based test to serve as a reliable method for ascertaining whether an entity is likely to require the protections of Securities Act registration.

To assist both issuers and investors, we propose to incorporate the definition of investments from Rule 2a51-1(b) under the Investment Company Act, which includes, among other things: securities; real estate, commodity interests, physical commodities, and non-security financial contracts held for investment purposes; and cash and cash equivalents.[155] By using an existing definition, we hope to alleviate confusion and facilitate compliance.

Request for Comment

24. Should we add a new category to the accredited investor definition for any entity with investments in excess of $5 million that is not formed for the specific

[155] *See* Rule 2a51-1(b), which was adopted by the Commission in Privately Offered Investment Companies, Release No. IC-22597 (Apr. 3, 1997) [62 FR 17512 (April 9, 1997)].

purpose of acquiring the securities being offered, while maintaining the current $5 million assets test for entities currently listed in Rules 501(a)(3) and (a)(7), as proposed? Are the entities that would be eligible under proposed Rule 501(a)(9) sufficiently different in nature from the enumerated entities in Rules 501(a)(3) and (a)(7) such that an investment test should be applied to demonstrate financial sophistication? If not, should Rule 501(a)(3) be expanded to include any entity that has more than $5 million in assets?

25. Instead of using the catch-all "any entity" in proposed Rule 501(a)(9), should we enumerate specific entity types? If so, which entity types should we enumerate?

26. Should any restrictions be applied with respect to entities covered by proposed Rule 501(a)(9)? For example, should we consider any restrictions on entities organized or incorporated under the laws of a foreign country?

27. Should we use an asset test instead of an investments test in proposed Rule 501(a)(9)? Should the current $5 million asset test be adjusted?

28. Is $5 million in investments the appropriate threshold for the proposed new category?

29. Proposed Rule 501(a)(9) is intended to capture all existing entity forms not already included within Rule 501(a), including Indian tribes and governmental bodies, that meet the proposed $5 million investments test. Would the investments test have a disproportionate impact on Indian tribes?

30. Should we use the definition of investments from Rule 2a51-1(b) under the Investment Company Act? If not, what definition should we use? Are market

participants familiar with the definition such that implementation would not be unduly difficult?

31. We are not proposing to revise Rule 501(a)(7). As a result, trusts with investments of more than $5 million would not need purchases to be directed by a sophisticated person in order to qualify as an accredited investor. Is this an appropriate result? Should trusts have purchases directed by a sophisticated person in order to qualify under proposed Rule 501(a)(9)?

32. In addition to, or in lieu of, proposed Rule 501(a)(9), should we revise the definition of accredited investor by replacing the $5 million assets test that currently applies to certain entities with a $5 million investments test? If so, should we also grandfather issuers' existing investors that are accredited investors under the current definition with respect to future offerings of their securities? Alternatively, should we retain the current assets test but revise the $5 million threshold? If so, what threshold would be appropriate?

5. Proposed Note to Rule 501(a)(8)

Under Rule 501(a)(8), an entity qualifies as an accredited investor if all of the equity owners of that entity are accredited investors. Because in some instances, an equity owner of an entity is another entity, not a natural person, we are proposing to add a note to Rule 501(a)(8) that would clarify that, in determining accredited investor status under Rule 501(a)(8), one may look through various forms of equity ownership to natural persons.[156] Thus, if those natural persons are themselves accredited investors, and if all

[156] This proposed note is consistent with an existing staff interpretation. *See* question number 255.06 of Securities Act Rules Compliance and Disclosure Interpretations, *available at* https://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm.

other equity owners of the entity are accredited investors, the entity would be an accredited investor under Rule 501(a)(8). We believe this approach is appropriate because the intent of Rule 501(a)(8) is to qualify as accredited investors those entities that are 100% owned by accredited investors and, for this purpose, it should not matter whether the ownership is direct or indirect.

Request for Comment

33. Should we add a note to clarify that one may look through various forms of equity ownership to natural persons when determining accredited investor status under Rule 501(a)(8)?

6. Certain Family Offices and Family Clients

In response to the 2015 Staff Report, the Commission received comments from a group of "family offices" recommending that the Commission amend the accredited investor definition to include "family offices" and "family clients," as the Commission has defined those terms.[157] "Family offices" are entities established by wealthy families to manage their wealth, plan for their families' financial future, and provide other services to family members. The Commission has previously observed that single family offices generally serve families with at least $100 million or more of investable assets.[158] Family offices generally meet the definition of "investment adviser" under the Advisers Act, as the Commission has interpreted the term, because, among the variety of services

[157] *See* letter from Martin E. Lybecker, Perkins Coie LLP (on behalf of Private Investor Coalition) dated August 8, 2016 ("2016 PIC Letter").

[158] *See* Family Offices, Release No. IA-3098 (Oct. 12, 2010) [75 FR 63753 (Oct. 18, 2010)] ("Family Office Proposing Release"). Industry observers have estimated that there are 2,500 to 3,000 single family offices managing more than $1.2 trillion in assets. *See* 2016 PIC Letter.

provided, family offices are in the business of providing advice about securities for compensation. However, the Commission adopted the "family office rule"[159] in 2011 to exclude single family offices from regulation under the Advisers Act under certain conditions.[160] Under that rule, a family office generally is a company that has no clients other than "family clients."[161] "Family clients" generally are family members, former family members, and certain key employees of the family office, as well as certain of their charitable organizations, trusts, and other types of entities.[162]

A commenter on the 2015 Staff Report stated that the public policy supporting the family office rule "is based on the notion that members of a family will protect each other, and that the investor protections of the Investment Advisers Act do not need to apply…."[163] The commenter suggested this public policy should apply to other securities laws as well.[164] The commenter also explained that the different standards under Commission rules sometimes result in an anomaly that a particular family client might

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[159] 17 CFR § 275.202(a)(11)(G)-1.

[160] *See* Family Offices, Release No. IA-3220 (June 22, 2011) [76 FR 37983 (June 29, 2011)] ("Family Office Adopting Release"). *See also* Family Office Proposing Release ("We viewed the typical single family office as not the sort of arrangement that Congress designed the Advisers Act to regulate. We also were concerned that application of the Advisers Act would intrude on the privacy of family members. … The Act was not designed to regulate the interactions of family members in the management of their own wealth.").

[161] A family office also (1) must be wholly owned by family clients and exclusively controlled (directly or indirectly) by one or more family members or family entities (each as defined in the rule), and (2) must not hold itself out to the public as an investment adviser. *See* Rule 202(a)(11)(G)-1(b).

[162] For a full list of family clients, see 17 CFR § 275.202(a)(11)(G)-1(d)(4). The family office rule defines a "family member" to include "all lineal descendants (including by adoption, stepchildren, foster children, and individuals that were a minor when another family member became a legal guardian of that individual) of a common ancestor (who may be living or deceased), and such lineal descendants' spouses or spousal equivalents; provided that the common ancestor is no more than 10 generations removed from the youngest generation of family members." 17 CFR§ 275.202(a)(11)(G)-1(d)(6).

[163] *See* 2016 PIC Letter.

[164] *See Id*. (recommending changes not only to the definition of "accredited investor," but also to the definitions of "qualified purchaser" and "investment company" in the Investment Company Act).

not meet the definition of accredited investor while it could meet the definition of "qualified purchaser,"[165] which has a higher financial threshold. The commenter reiterated these assertions in its recent comment letter on the Concept Release and suggested that we add a new category of investor to the accredited investor definition that would apply to "(i) a Family Office with assets under management in excess of $5,000,000 and (ii) a Family Office or a Family Client (a) that is not formed for the specific purpose of acquiring the securities offered and (b) whose purchase is directed by a person who has such knowledge and experience in financial and business matters that such person is capable of evaluating the merits and risks of a potential investment."[166] Another commenter on the Concept Release raised similar points and urged the Commission to, among other things, amend the definition of accredited investor to include a family client of a family office so long as it relied on advice and sophistication of the family office.[167]

We believe the policy rationale for adopting the family office rule also supports considering amendments to the definition of accredited investor for family offices and their family clients. We believe family offices can sustain the risk of loss of investment, given their assets. As a result, we are proposing to add new categories to the accredited investor definition for "family offices" and "family clients of family offices."

Drawing from characteristics in the current definition of accredited investor and from commenter feedback, we propose to amend the definition to include any "family

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[165] Investment Company Act Section 2(a)(51)(A) (15 U.S.C. 80a-2(a)(51)(A)).

[166] *See* 2019 PIC Letter.

[167] *See* letter from Institutional Limited Partners Association dated September 24, 2019.

office" with at least $5 million in assets under management[168] and its "family clients,"[169] each as defined in the family office rule. We believe requiring the family office to have a minimum amount of assets under management, as suggested by commenters, would ensure the family office has sufficient assets to sustain the risk of loss. In addition, the proposed definition would apply only to a family office whose purchase is directed by a person who has such knowledge and experience in financial and business matters that such family office is capable of evaluating the merits and risks of the prospective investment. In order to avoid improper reliance on the amended rule, we also propose that the family office not be formed for the specific purpose of acquiring the securities offered[170] and that a family client must be a family client of a family office that meets these requirements.[171] We expect that all or most current family offices would be accredited investors under the proposed amendments to the definition.

Request for Comment

34. Should family offices and their family clients qualify as accredited investors?

35. Do the proposed new categories for these investors have the proper scope? If not, what parameters would be more appropriate? If yes, which ones and why? If not, why not? Are we correct that all or most family offices and their clients would qualify as accredited investors under the proposed amendments?

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[168] Proposed Rule 501(a)(12).

[169] Proposed Rule 501(a)(13).

[170] Proposed Rule 501(a)(12)(i).

[171] Proposed Rule 501(a)(13).

36. Should we require that the purchase be directed by a person who has the requisite knowledge and experience in financial and business matters? How would issuers assess this in practice?

37. Would it be appropriate to impose a financial threshold for a family office to qualify as an accredited investor as proposed? Should we also impose a financial threshold for a family client to qualify? In either case, what is the appropriate threshold? For instance, should there be a minimum investment amount or minimum assets under management?

38. Are there specific categories of family clients that should be excluded? For instance, should the proposed rule exclude anyone who is not a "family member," as defined in the family office rule?[172] Should a family client qualify as an accredited investor if it becomes a "former family client," as defined in the family office rule?[173]

39. Rule 202(a)(11)(G)-1 under the Advisers Act deems a person who receives assets upon the death of a family member (or other involuntary transfer from a family member) to be a family client ("a beneficiary") for only one year following the involuntary transfer.[174] Should such a beneficiary qualify as an accredited investor during that year if the beneficiary would not otherwise qualify?

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[172] *See* Rule 202(a)(11)(G)-1(d)(6).

[173] *See* Rule 202(a)(11)(G)-1(d)(7).

[174] *See* Rule 202(a)(11)(G)-1(b).

D. Permit Spousal Equivalents to Pool Finances for the Purposes of Qualifying as Accredited Investors

Under the current accredited investor definition, an individual, together with a spouse, may qualify as an accredited investor by either surpassing the $300,000 joint income threshold[175] or the $1 million joint net worth threshold.[176] The Commission did not define the term "spouse" when it originally adopted Regulation D,[177] nor did it do so when adding the joint income test to the accredited investor definition in 1988.[178] Currently, references to "spouse" in Rule 501 include individuals married to persons of the same sex.

The 2015 Staff Report noted uncertainties regarding whether persons in legally recognized unions, such as domestic partnerships, civil unions, and same-sex marriages, were considered spouses for purposes of the accredited investor definition. The 2015 Staff Report recommended that the Commission consider adding the term "spousal equivalent" to the accredited investor definition to permit spousal equivalents to pool finances for the purpose of qualifying as accredited investors. Commenters' responses were mixed, with several commenters generally supporting the recommendation[179] and one commenter opposing it.[180]

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[175] Rule 501(a)(6).

[176] Rule 501(a)(5).

[177] *See* Regulation D 1982 Adopting Release.

[178] *See* Regulation D 1988 Adopting Release.

[179] *See* CFA/AFR Letter (stating that this recommended change "helps to bring the securities laws up to date with modern values and expectations"); NSBA Letter (noting that this recommended change would "expand opportunities to invest in small businesses to more households"); and 2016 SBIA Letter.

[180] *See* Cornell Law Clinic Letter (noting that federal law does not treat marriages as equivalent to civil unions and domestic partnerships, and that "the family office rule, accountant independence standards, and crowdfunding rules are fundamentally different in nature from the accredited investor definition").

To address any uncertainties, we propose to allow natural persons to include joint income from spousal equivalents when calculating joint income under Rule 501(a)(6), and to include spousal equivalents when determining net worth under Rule 501(a)(5). We see no reason to distinguish between different types of relationship structures for the purpose of these rules and, in that regard, believe that the proposed amendments would remove unnecessary barriers to investment opportunities for spousal equivalents.

The proposed amendments would define spousal equivalent as a cohabitant occupying a relationship generally equivalent to that of a spouse. The Commission previously has used this formulation of spousal equivalent.[181] As discussed above, a family office is exempted from regulation under the Advisers Act when the family office advises "family clients."[182] The Commission defined "family clients" to include "family members," of which "spousal equivalents" are a part, with "spousal equivalent" defined as a cohabitant occupying a relationship generally equivalent to that of a spouse.[183] The crowdfunding rules adopted to implement the requirements of Title III of the JOBS Act also use this definition of "spousal equivalent."[184] In Regulation Crowdfunding, the Commission included the term "spousal equivalent" in the definition of the term "member of the family of the purchaser or the equivalent," with "spousal equivalent" having the same definition used in the Advisers Act and as the one we propose in this

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[181] Though the Commission rule governing accountant independence also includes "spousal equivalents," the term is not defined in that rule. *See* 17 CFR 210.2-01.

[182] *See* Family Office Adopting Release.

[183] Rule 202(a)(11)(G)-1(d)(9).

[184] The JOBS Act provides that securities issued in reliance on the crowdfunding exemption may not be transferred by the purchaser for one year after the date of purchase, except when transferred to, among other persons, "a member of the family of the purchaser *or the equivalent*" (emphasis added). JOBS Act Section 302(e)(1)(D).

release.[185] In response to the Concept Release, several commenters supported allowing spousal equivalents to pool finances for purposes of qualifying as accredited investors.[186]

We see no need to deviate from the definition of "spousal equivalent" already used in Commission rules. Revising Rule 501(a)(5) and (6) to permit spousal equivalents to pool their financial resources would promote consistency with these existing rules.

Request for Comment

40. Should we allow spousal equivalents to pool finances for the purpose of qualifying as accredited investors? If so, is our proposed definition of "spousal equivalent" appropriate? If not, what definition should we use?

E. Proposed Amendment to Rule 215

Rule 215 defines the term "accredited investor" under Section 2(a)(15) of the Securities Act[187] for purposes of Section 4(a)(5) of the Securities Act.[188] The accredited investor definition in Rule 215 has historically been substantially consistent but not identical to the accredited investor definition in Rule 501(a) of Regulation D. For

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[185] 17 CFR 227.501(c).

[186] *See* J. Wallin Letter; EquityZen Letter; 2019 SBIA Letter; IPA Letter; Artivest Letter; ABA Fed. Reg. of Sec. Comm. Letter; Sec. Reg. Comm. of N.Y.St. B.A. Letter; and CrowdCheck Letter. In addition to these comments, the Commission previously received a request for rulemaking petition from David L. Dallas, Jr. dated September 16, 2013, *available at* https://www.sec.gov/rules/petitions/2013/petn4-665.pdf, requesting that the Commission "revise Rule 501 of Regulation D to afford to persons in civil unions, domestic partnerships, and similar relationships, the same right and opportunity to qualify for accredited investor status as married persons have."

[187] 15 U.S.C. 77b(a)(15). Section 2(a)(15) sets forth an enumerated list of entities that qualify as accredited investors as well as "any person who, on the basis of such factors as financial sophistication, net worth, knowledge, and experience in financial matters, or amount of assets under management qualifies as an accredited investor under rules and regulations which the Commission shall prescribe."

[188] 15 U.S.C. 77d(a)(5). Section 4(a)(5) of the Securities Act provides an exemption for issuers for the offer and sale of securities to accredited investors if the aggregate offering amount does not exceed $5 million; the issuer, or anyone acting on its behalf, does not engage in general solicitation or general advertising; and the issuer files a notice on Form D with the Commission. Based on DERA staff's review of Form D filings from January 1, 2009 through November 30, 2019, no issuer reported relying on the Section 4(a)(5) exemption during that time period.

example, in contrast to the definition in Rule 501(a), the scope of the accredited investor definition in Rule 215 does not include banks, insurance companies, registered investment companies, business development companies as defined in Section 2(a)(48) of the Investment Company Act, or SBICs. In addition, the accredited investor definition in Rule 215 does not contain a reasonable belief standard as in Rule 501(a).[189]

We propose to amend the accredited investor definition in Rule 215 to conform to the amendments to the accredited investor definition in Rule 501(a). To ensure uniformity in the accredited investor definition in both provisions, we propose to replace the existing definition in Rule 215 with a cross reference to the accredited investor definition in Rule 501(a). By including this cross reference, the definition of "accredited investor" in Rule 215 as amended would be expanded to include any amendments to the accredited investor definition in Rule 501(a), as well as those entities that are presently included in the definition in Rule 501(a) but not the definition in Rule 215. As amended, the definition would also contain the same reasonable belief standard as in Rule 501(a).

Request for Comment

41. Should the Commission amend Rule 215 by replacing the existing text with a cross reference to the accredited investor definition in Rule 501(a) as proposed? Should the Commission instead incorporate any amendments to the accredited investor definition in the text of Rule 215?

42. Would amending the scope of the accredited investor definition in Rule 215 to encompass any amendments to the accredited investor definition in Rule 501(a) as

[189] Under Rule 501(a), natural persons and entities that come within any of eight enumerated categories in the definition, or that the issuer reasonably believes comes within any of the categories, are accredited investors.

well as certain entities that are currently included in the definition in Rule 501(a) raise concerns regarding the application of the Section 4(a)(5) exemption? Would adding a reasonable belief standard to the definition in Rule 215 raise concerns?

43. Would the proposed amendment to the accredited investor definition in Rule 215 affect an issuer's considerations in determining whether to use the Section 4(a)(5) exemption? Would issuers be more likely to use the Section 4(a)(5) exemption?

F. Proposed Amendment to Rule 163B

In registered offerings under the Securities Act, issuers may engage in test-the-waters communications with qualified institutional buyers or institutional accredited investors to gauge their interest in a contemplated offering. Under Section 5(d) of the Securities Act, an emerging growth company, as defined in Securities Act Rule 405, is permitted to engage in oral or written communications with potential investors that are either qualified institutional buyers, as defined in Rule 144A(a)(1), or institutions that are accredited investors as defined in Rule 501(a), to offer securities before or after the filing of a registration statement. In September 2019, the Commission adopted Securities Act Rule 163B, which extends this testing-the-waters accommodation to all issuers.[190] Pursuant to Rule 163B, an issuer may engage in test-the-waters communications with potential investors that are, or that the issuer or person authorized to act on its behalf reasonably believes are, qualified institutional buyers, as defined in Rule 144A, or institutions that are accredited investors, as defined in Rule 501(a)(1), (a)(2), (a)(3), (a)(7), or (a)(8).

[190] Solicitations of Interest Prior to a Registered Public Offering, Release No. 33-10699 (Sept. 25, 2019) [84 FR 53011 (Oct. 4, 2019)].

In connection with the proposed amendments to the accredited investor definition in Rule 501(a), we propose to amend Rule 163B to include a reference to proposed Rules 501(a)(9) and (a)(12). The proposed amendment to Rule 163B would maintain consistency between Rule 163B and Section 5(d), in that institutional accredited investors under proposed Rules 501(a)(9) and (a)(12), if adopted, would automatically fall within the scope of Section 5(d). We believe that expanding the types of entities with whom an issuer may engage in these test-the-waters communications, by amending the accredited investor definition and the qualified institutional buyer definition,[191] may increase the use of Rule 163B, as well as Section 5(d), and may result in issuers more effectively gauging market interest in contemplated registered offerings. We also believe that the expanded scope of entities that would receive these test-the-waters communications under the proposed amendment to Rule 163B have the financial sophistication to process this information and to review the registration statement that is filed with the Commission against the test-the-waters materials before making an investment decision.

Request for Comment

44. Should the Commission amend Securities Act Rule 163B to include a reference to proposed Rules 501(a)(9) and (a)(12)?

45. Would the proposed amendments to the accredited investor definition and the qualified institutional buyer definition raise concerns in connection with the test-the-waters communications that issuers may engage in pursuant to Rule 163B or Section 5(d) of the Securities Act?

[191] The proposed amendments to the qualified institutional buyer definition in Rule 144A are discussed below in Section IV.

G. Proposed Amendment to Exchange Act Rule 15g-1

Pursuant to Exchange Act Rule 15g-2 through Rule 15g-6, broker-dealers are required to disclose certain specified information to their customers prior to effecting a transaction in a "penny stock," as defined in 17 CFR 240.3a51-1 under the Exchange Act.[192] Rule 15g–1 under the Exchange Act exempts certain transactions from these disclosure requirements. In particular, paragraph (b) of Rule 15g-1 exempts transactions in which the customer is an institutional accredited investor, as defined in Rule 501(a)(1), (2), (3), (7), or (8) of Regulation D.[193]

In connection with the proposed amendments to the accredited investor definition in Rule 501(a), we propose to amend Rule 15g-1(b) to include a reference to proposed Rules 501(a)(9) and (a)(12).[194] We believe that, like the institutional accredited investors currently within the scope of Rule 15g-1(b) as well as those that we propose to add to the accredited investor definition in Rule 501(a)(1), entities owning investments in excess of $5 million that are not formed for the specific purpose of acquiring the securities being offered and family offices are less in need of the protections provided by Rules 15g-2 through 15g-6.[195] We believe that, consistent with the categories of institutional

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[192] Rules 15g-1 through 15g-9 under the Exchange Act [17 CFR 240.15g-2 through 15g-9] are collectively known as the "penny stock rules." *See also* Schedule 15G under the Exchange Act.

[193] In addition, Rule 15g-1(a), (d), (e), and (f) exempt certain other transactions from the disclosure requirements in Rules 15g-2 through 15g-6. Rule 15g-1(c) exempts transactions that meet the requirements of Regulation D or that are exempt from the registration requirements of the Securities Act pursuant to Section 4(a)(2). Rule 15g-1 also includes a provision the Commission can use to exempt by order any other transactions or persons from the penny stock rules as consistent with the public interest and the protection of investors.

[194] We are also proposing a technical amendment to Rule 15g-1(c) to update the reference to Section 4(2) of the Securities Act to reflect the current numbering scheme in Section 4.

[195] As discussed above, we are also proposing to amend a number of the existing categories in the accredited investor definition relating to institutional investors that fall within the scope of the exemption in Rule 15g-1(b).

accredited investors presently listed in Rule 15g-1(b), entities within the scope of proposed Rule 501(a)(9), family offices, and the other types of entities we propose to add to the accredited investor definition generally: invest in speculative equity securities as part of an overall investment plan, have a good understanding of the risks of investing in penny stocks, and have the ability to obtain and evaluate independent information regarding these stocks.[196]

Request for Comment

46. Should the Commission amend Rule 15g-1(b) to include a reference to proposed Rule 501(a)(9)? Are there certain entities that would fall within the scope of proposed Rule 501(a)(9) that have more need for the disclosures required under Rules 15g-2 through 15g-6?

47. Should the Commission amend Rule 15g-1(b) to include a reference to proposed Rule 501(a)(12)?

48. As discussed above, the Commission is proposing to expand the list of entities that would qualify for accredited investor status under Rule 501(a)(1). Should the entities that are proposed to be added under Rule 501(a)(1) be included in the exemption set forth in Rule 15g-1(b)? Would certain of these entities have more need for the disclosures required under Rules 15g-2 through 15g-6?

49. As discussed above, the Commission is proposing to codify a longstanding staff position that limited liability companies that satisfy the other requirements of the definition are eligible to qualify as accredited investors under Rule 501(a)(3).

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[196] *See* Penny Stock Disclosure Rules, Release No. 34-29093 (Apr. 17, 1991) [56 FR 19165 (Apr. 25, 1991)] and Penny Stock Disclosure Rules, Release No. 34-30608 (Apr. 20, 1992) [57 FR 18004 (Apr. 28, 1992)].

Should these limited liability companies continue to be included in the exemption set forth in Rule 15g-1(b)? Do limited liability company investors have more need for the disclosures required under Rules 15g-2 through 15g-6?

III. ADDITIONAL REQUESTS FOR COMMENT ON THE ACCREDITED INVESTOR DEFINITION

In the Concept Release, we requested comment on whether we should revise the financial thresholds in the accredited investor definition. Specifically, we requested comment on, among other things, three recommendations that the Commission staff included in the 2015 Staff Report: (1) leaving the current income and net worth thresholds in place, subject to investment limits; (2) creating new, additional inflation-adjusted income and net worth thresholds that are not subject to investment limits; or (3) indexing all financial thresholds for inflation on a going-forward basis.[197] Table 3 below provides an overview of the feedback provided by commenters on the Concept Release about each of the three recommendations.

[197] The comments on these recommendations received in response to the 2015 Staff Report are described in Section II.A.4 of the Concept Release. Following release of the 2015 Staff Report, the Commission continued to receive recommendations about revising the financial thresholds in the accredited investor definition from a number of parties. In July 2016, the Advisory Committee on Small and Emerging Companies recommended, among other things, that the Commission not change the current financial thresholds in the accredited investor definition except to adjust them, on a going-forward basis, to reflect inflation. See 2016 ACSEC Recommendations. The 2016, 2017, and 2018 Small Business Forum Reports all included a recommendation that the Commission maintain the monetary thresholds for accredited investors but did not include a recommendation for future inflation adjustments. The 2019 Small Business Forum Report included a recommendation that the Commission revise the dollar amounts in the definition to scale for geography, lowering the thresholds in states or regions with a lower cost of living.

Table 3: Responses to requests for comment on financial thresholds in the accredited investor definition

Staff Request for Comment	Responses from Commenters
Leave the current income and net worth thresholds in place, subject to investment limits.	- Several commenters opposed subjecting the current thresholds to investment limits.[198] - Several commenters supported making the net worth and income requirements more inclusive.[199]
Add new inflation-adjusted income and net worth thresholds that are not subject to investment limits.	- Two commenters supported raising the income and net worth thresholds immediately.[200] - Several commenters opposed raising the income and net worth thresholds.[201]
Index all financial thresholds in the definition for inflation on a going-forward basis.	- Several commenters opposed indexing financial thresholds to inflation.[202] - Several commenters supported indexing financial thresholds to inflation going forward.[203]

[198] *See* J. Wallin Letter; 2019 SBIA Letter; ABA Fed. Reg. of Sec. Comm. Letter; Sec. Reg. Comm. of N.Y.St. B.A. Letter; and CrowdCheck Letter.

[199] *See* letter from Logan B. dated June 24, 2019 (suggesting that the thresholds be lowered); letter from Herwig Konings dated June 24, 2019 (requesting the inclusion of more retail investors without specifically recommending that the thresholds be lowered); letter from J.C. dated July 10, 2019 (suggesting that the thresholds be lowered); letter from Stephen R. Steciak dated August 4, 2019 (suggesting a dollar credit against the net worth requirement if the investor was a college graduate or held a securities license); letter from Barry Hicks dated September 16, 2019 (suggesting that the thresholds be lowered); P. Rutledge Letter (suggesting that the thresholds be lowered if certain assets were excluded from the net worth definition); letter from Silicon Prairie Holdings dated September 24, 2019 (suggesting that the thresholds be lowered); letter from Luke Carriere dated September 24, 2019 (suggesting that the thresholds be lowered); letter from Steven Richards dated September 24, 2019 (suggesting that the thresholds be lowered); and REDCO Letter (suggesting that the net worth threshold be lowered for certain regions of the country).

[200] *See* letter from Marc Steinberg dated August 5, 2019; and letter from NASAA dated October 11, 2019 ("2019 NASAA Letter").

[201] *See* Wefunder Letter; ACA Letter; HFA Letter; Funding Circle Letter; MLA Letter; J. Wallin Letter; Republic Letter; MFA and AIMA Letter; EquityZen Letter; D. Burton Letter; CoinList Letter; 2019 SBIA Letter; IPA Letter; Sec. Reg. Comm. of N.Y.St. B.A. Letter; and CrowdCheck Letter.

[202] *See* 2019 SBIA Letter; AngelList Letter; CCMC Letter; and IPA Letter.

[203] *See* Wefunder Letter; P. Rutledge Letter; CFA Institute Letter; MFA and AIMA Letter (stating that indexing to inflation would "help to ensure that the thresholds have not been diluted over time"); Consumer Federation Letter; EquityZen Letter; ICI Letter; MA Secretary Letter; Davis Polk Letter; PIABA Letter; ADISA Letter; Artivest Letter; letter from Elizabeth D. de Fontenay et al. dated September 24, 2019 (stating that "inflation undermines the effectiveness of the safeguards built into the Accredited Investor net-

In addition to comments received on the specific questions relating to inflation adjustments, the Commission also received input from commenters who questioned the correlation between wealth and financial sophistication and were of the view that the income and net worth tests fail to identify correctly those individuals who should be accredited investors.[204]

We believe that the current wealth-based criteria are useful for the identification of investors who do not require the protections afforded by registration, even though we also believe they have excluded investors who are financially sophisticated, such as those with certain professional certifications and designations who do not meet these criteria.[205] Accordingly, we believe the use of financial thresholds as one method of qualifying as an accredited investor is appropriate. These financial thresholds have not been adjusted for inflation since they were adopted.[206] For example, the $5 million asset test for certain entities, if adjusted for inflation since 1982 to 2019 dollars using the Consumer Price Index for All Urban Consumers ("CPI-U") published by the Bureau of Labor Statistics ("BLS"), would result in a $13 million asset test. Similarly adjusting the $200,000 income test for natural persons results in a $520,000 threshold, while adjusting the $300,000 joint income test for natural persons from 1988 dollars to 2019 dollars would

worth and income tests"); 2019 NASAA Letter; Sec. Reg. Comm. of N.Y.St. B.A. Letter; CrowdCheck Letter; and 2019 Advisory Committee Recommendation.

[204] *See, e.g.*, 2019 NASAA Letter; Consumer Federation Letter; and 2014 Investor Advisory Committee Recommendation.

[205] As described in the 2015 Staff Report, there are academic studies that lend support to the theory that wealth is correlated to financial sophistication. See Section IV.B of the 2015 Staff Report.

[206] *See* Regulation D 1982 Adopting Release; Regulation D 1988 Adopting Release; and Regulation D 1989 Adopting Release.

require a joint income of $632,000. Table 4 below sets forth our estimation of the approximate number and percentage of U.S. households that currently qualify as accredited investors under the existing criteria and that qualified as accredited investors in 1983 and 1989.[207]

[207] For this analysis, we use the same methodology and variable definitions as the 2015 Staff Report. The underlying household data for this analysis was obtained from the Federal Reserve Board's Survey of Consumer Finances (the "SCF") for 2016, *available at* https://www.federalreserve.gov/econresdata/scf/scfindex.htm. The SCF is a triennial survey that provides insights into household income and net worth, where the household is considered to be the primary economic unit within a family. As of the date of this release, the most recent SCF data is from the 2016 survey. The SCF employs weights to make the data representative of the U.S. population. Thus, the 1983, 1989, and 2016 SCF and are representative of the U.S. population in 1983 (approximately 83.9 million households), 1989 (approximately 92.8 million households), and 2016 (approximately 125.9 million households), respectively.

The 2015 Staff Report used the definitions of income and net worth from Jesse Bricker, Lisa J. Dettling, Alice Henriques, Joanne W. Hsu, Kevin B. Moore, John Sabelhaus, Jeffrey Thompson, and Richard A. Windle, Changes in U.S. Family Finances from 2010 to 2013: Evidence from the Survey of Consumer Finances, Federal Reserve Bulletin, Vol. 100, No. 4 (2014).

We estimate households and not individuals due to data limitations because the database underlying our analysis measures wealth and income at the household level. It should be noted that in the SCF database, income is reported at the household level. Similar to the 2015 Staff Report, we do not attempt to differentiate income based on marital status of the household because data on individual income from all sources is not publicly available in the database. As a result, accredited investor (household) estimates based on individual income thresholds are likely to be overestimated and would represent upper bounds. A household can have multiple family members with independent sources of income that qualify them as accredited investors based on income. We count them as one accredited investor for each household, which implies we are also likely underestimating the actual pool of accredited investors when we provide household estimates. Consequently, the household estimates we derive using the joint income threshold would represent a lower bound for individuals qualifying on the basis of income. The actual number of individuals that qualify as accredited investors on an income basis (individual or joint) would, in all likelihood, lie between the estimates that we derive for the individual income threshold and the joint income threshold.

Table 4: Households qualifying under existing accredited investor criteria
(standard errors are in parentheses)

Basis for Qualifying as Accredited Investor	1983		1989		2019	
	Number of qualifying households	Qualifying households as % of U.S. households	Number of qualifying households	Qualifying households as % of U.S. households	Number of qualifying households*	Qualifying households as % of U.S. households*
Individual income[208] threshold ($200,000)	0.44 million (0.10 million)	0.53% (0.12%)	4.3 million (0.4 million)	4.7% (0.5%)	11.2 million (0.3 million)	8.9% (0.2%)
Joint income threshold[209] ($300,000)	N/A	N/A	2.1 million (0.3 million)	2.3% (0.4%)	5.8 million (0.2 million)	4.6% (0.2%)
Net worth[210] ($1,000,000)	1.18 million (0.17 million)	1.4% (0.20%)	4.5 million (1.0 million)	4.8% (1.1%)	11.8 million (0.3 million)	9.4% (0.2%)
Overall number of qualifying households[211]	1.31 million (0.18 million)	1.6% (0.21%)	6.8 million (1.0 million)	7.3% (1.1%)	16.0 million (0.3 million)	13.0% (0.2%)

[208] For purposes of this analysis, income is defined to include wage income, business income, rent income, interest and dividend income, pension income, social security income, income from retirement accounts, transfers, and other income. According to the SCF documentation, income data is collected for the year prior to the year of the SCF while family balance sheet data covers the status of the family at the time of the interview. Thus, we use income data inflation-adjusted to 2016. Further, for comparability, income data is adjusted for inflation by a factor of 1.05914411 from 2016 dollars to March 2019 dollars using Consumer Price Index for All Urban Consumers ("CPI-U") data from the BLS.

[209] *See supra* note 207. Joint income was added to Rule 501(a) in 1988.

[210] For purposes of this analysis, net worth is defined as the difference between household assets and household debt. Assets include all financial assets (stocks, bonds, mutual funds, cash and cash management accounts, retirement assets, life insurance, managed assets like trusts and annuities, and other financial assets like deferred compensation, royalties, futures, etc.) and non-financial assets. Debt includes mortgage and home equity loans, lines of credit, credit card debt, installment loans including vehicle loans, margin loans, pension loans, and other debt (*e.g.*, loans against insurance). For comparability, we exclude the value of the household's principal residence and any outstanding mortgages associated with the principal residence from the 1983, 1989, and 2016 SCF. Further, for comparability, net worth data is adjusted for inflation by a factor of 1.05914411 from 2016 dollars to March 2019 dollars using BLS CPI data.

[211] The number of households qualifying under either the income or net worth criterion is smaller than the sum of the number of households qualifying under the income criterion and the number of households qualifying under the net worth criterion because some households may qualify under both criteria.

The data above provides an estimate of the overall pool of qualifying households in the United States. It does not, however, represent the actual number of accredited investors that do or would invest in the Regulation D market or in other exempt offerings.[212] In addition, while we have information to estimate the number of some categories of accredited investor entities, we lack comprehensive data that will allow us to estimate the unique number of accredited investors across all categories of entities under Rule 501(a).

Notwithstanding the significant increase in the number of investors that qualify as accredited investors since 1982, we do not believe it necessary or appropriate to modify the definition's financial thresholds at this time.[213] According to the U.S. Census Bureau, the number of U.S. households has grown from approximately 83.9 million households to approximately 127.6 million households from 1983 to 2018, and the population of U.S. residents has grown from 236.4 million to an estimated 327.1 million over this same period.[214] Although it may be argued that an investor with an income of $200,000 or a net worth of $1 million in 2019 is not as "wealthy" as such an investor would have been in 1982, the income and net worth levels currently required in the definition still exceed,

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[212] Form D data and other data available to us on private placements do not allow us to estimate the number of unique accredited investors participating in exempt offerings.

[213] The Commission has previously considered whether to revise the financial thresholds in the accredited investor definition. In the 2007 Proposing Release, the Commission proposed to maintain the thresholds but to apply an inflation adjustor every five years. *See* 2007 Proposing Release at 45126. However, the Commission took no further action on the proposing release.

[214] *See* the U.S. Census Bureau's time-series of U.S. households, *available at* https://www2.census.gov/programs-surveys/demo/tables/families/time-series/households/ and the U.S. Census Bureau's monthly estimates of the U.S. population, April 1,1980 to July 1, 1990, *available at* https://www2.census.gov/programs-surveys/popest/tables/1990-2000/national/totals/nat-total.txt and U.S. Census Bureau's Quick Facts, *available at* https://www.census.gov/quickfacts/fact/table/US/PST045218.

by a large margin, the mean and median household income and household net worth in all regions of the country.[215] Also, in 1982, the calculation of net worth included the value of the primary residence. In 2011, the Commission amended the net worth standard to exclude the value of the investor's primary residence.[216] Further, we believe that in evaluating the effectiveness of the current thresholds, it is appropriate to consider changes beyond the impact of inflation, such as changes over the years in the availability of information and advances in technologies. Given the rise of the internet, social media, and other forms of communication, information about issuers and other participants in the exempt markets is more readily available to a wide range of market participants. Technologies such as powerful home computers and mobile computing devices, as well software-based tools with which to evaluate investment opportunities, were not available to investors at the time the accredited investor definition was promulgated. In addition, we are not aware of widespread problems or abuses associated with Regulation D offerings to accredited investors that would indicate that an immediate and/or significant adjustment to the rule's financial thresholds is warranted.

We are also mindful that a significant reduction in the accredited investor pool through an increase in the definition's financial thresholds could have disruptive effects on the Regulation D market, which, as noted above, plays a vital role in U.S. capital

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[215] The median household income in the U.S. in 2018 was $61,937. *See* Household Income: 2018, American Community Survey Briefs, *available at* https://www.census.gov/content/dam/Census/library/publications/2019/acs/acsbr18-01.pdf. The median (average) net worth in the U.S. was $29,410 ($196,200) in 2016. *See* the U.S. Census Bureau's Survey of Income and Program Participation (SIPP), Wealth, Asset Ownership, & Debt of Households Detailed Tables: 2016, *available at* https://www.census.gov/data/tables/2016/demo/wealth/wealth-asset-ownership.html. The reported net worth estimates exclude the value of personal home equity from the net worth calculations.

[216] *See* Regulation D 2011 Adopting Release.

formation.[217] For example, a sharp decrease in the accredited investor pool may result in a higher cost of capital for companies, particularly companies in regions of the country with lower venture capital activity who may rely on "angel" or other individual investors as a primary source of funding.[218] Placing limits on the amount that a person may invest under the current income and net worth thresholds could have similarly disruptive effects on the Regulation D market.

Further, raising the financial thresholds from current levels may have disparate impacts on certain investors. For example, certain geographic areas of the United States, such as the Midwest and South, have a lower cost of living compared to other geographic areas and employees in those areas may be earning lower wages relative to other areas and therefore be less likely to qualify as accredited investors under the current financial thresholds. An increase in the financial thresholds would exacerbate this current disparity and would be more likely to result in the loss of accredited investor status for investors in those geographic areas. Adjusting the thresholds upward could curtail the ability of many financially sophisticated people in certain parts of the country from investing in local companies, about which they have first-hand knowledge.

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[217] For example, substantially increasing the thresholds to, for example, reflect inflation since they were adopted, would reduce significantly the number of individuals that currently qualify as accredited investors under those tests. Such an increase would reduce the percentage of qualifying households from approximately 13.0% today to approximately 4.2%.

[218] For example, Lindsey and Stein (2019) examined the effects of changes in angel financing stemming from the 2011 Dodd-Frank Act's exclusion of an investor's primary residence in determining an accredited investor's net worth. They found that a larger reduction in the pool of potential accredited investors negatively affects firm entry and reduces employment levels at small entrants and that relative wages for the startup sector decline. As the pool of potential accredited investors was reduced, they found negative affects to firm entry, reduced employment levels at small entrants, and a decline in relative wages for the startup sector.

Below we present information on median and mean income and net worth of U.S. households in major U.S. geographic regions. The data shows that household income and net worth tend to be lower in the Midwest and South regions.

Table 5: U.S. household income and net worth, by region[219]

($ thousands)	Northeast	Midwest	South	West
Mean household income (before-tax)	136.5	102.0	100.0	108.5
Median household income (before-tax)	64.4	54.7	51.5	57.5
Mean household net worth	851.3	658.8	636.9	873.7
Median household net worth	154.5	103.2	87.0	114.3

Moreover, increasing the total assets test to reflect inflation could cause smaller entities that currently qualify as accredited investors to no longer qualify. Such an immediate increase could be highly disruptive for smaller entities, preventing them from accessing an important segment of the private markets.

While we are not proposing to amend the financial thresholds in the accredited investor definition at this time, we are requesting further comment on possible approaches to adjusting these financial thresholds. If the financial thresholds in the definition remain constant, the pool of accredited investors would likely continue to expand as a result of inflation. It is challenging to generate a precise forecast of how much the pool of accredited investors will expand in the future, particularly over longer

[219] The Federal Reserve Board's 2016 SCF Chartbook, *available at* https://www.federalreserve.gov/econres/files/BulletinCharts.pdf, at 28, 29, 64, and 65. The public version of the SCF database does not provide information regarding geographical location of households. As a result, we are unable to identify in which states households that qualify as accredited investors are likely to be concentrated. Unlike Table 4, in which we exclude the value of the primary residence from net worth, Table 5 does not exclude the value of the primary residence from the net worth of households. The figures were adjusted for inflation to March 2019 dollars using BLS CPI data.

time periods.[220] We expect that the Commission will continue to monitor the size of this pool as well as the percentage and types of individuals from this pool who participate in our private markets, including in connection with its quadrennial review of the accredited investor definition required by the Dodd-Frank Act.

As a result, the investor protections provided by the current thresholds could erode over time due to inflation to the extent the effects of such inflation on the pool of potential accredited investors were not offset by other changes in the investing environment that enhanced the ability of investors to analyze investment opportunities and make informed investment decisions in private markets. Rather than mandate a prospective adjustment for the effects of inflation, we believe it would be more appropriate for the Commission to consider the impact, if any, of inflation on the pool of accredited investors in connection with its quadrennial review of the accredited investor definition. Under this approach, the Commission could take into account not just inflation but all developments with respect to private investing as it considers the need for any changes in the accredited investor definition. However, adjusting the financial

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[220] The proportion of households that meets the income or net worth thresholds would depend on the evolution of nominal income (i.e., income level affected by inflation and real growth,) and net worth across different levels of income and net worth. With inflation or real growth in the economy, the proportion of households that meets these thresholds at their current levels is expected to increase over time.

For example, to illustrate the effects of inflation, assuming, among other things, no change in savings, we expect households with a current net worth between approximately $985,000 and $999,999 would meet the net worth threshold if their assets grew by 1.51%, the estimated annual rate of inflation between 2013 and 2018, over one year. (To calculate this inflation rate, we use CPI-U data from the BLS, *available at* https://www.bls.gov/regions/mid-atlantic/data/consumerpriceindexhistorical_us_table.htm.) This could increase the proportion of households that meets the net worth threshold by 0.1 percentage points, to 9.5%. Similarly, we expect that individuals with a current income between approximately $197,000 and $199,999, to the extent they experienced one year of income growth equal to the estimated annual rate of inflation between 2013 and 2018, to meet the income threshold for individuals. This could increase the proportion of individuals that meets the income threshold by 0.31 percentage points, to 9.21%. *See also supra* Table 4.

thresholds, for example, by indexing for inflation, could raise some of the concerns discussed above or have other adverse ramifications on the Regulation D market.

In addition to feedback on possible adjustments to the financial thresholds in the definition, we are requesting further comment on whether we should permit an investor, whether a natural person or an entity, that is advised by a registered investment adviser or broker-dealer to be considered an accredited investor. The 2017 Treasury Report recommended that the Commission undertake amendments to the accredited investor definition, including by broadening the definition to include, among other things, any investor who is advised on the merits of making a Regulation D investment by a fiduciary, such as an SEC- or state-registered investment adviser. As noted in the Concept Release, being advised by a financial professional has not been a complete substitute historically for the protections of the Securities Act registration requirements and, if applicable, the Investment Company Act.[221] Commenters on the Concept Release who addressed this topic were generally supportive of expanding the accredited investor definition in this manner,[222] though other commenters were opposed to or expressed concern regarding this approach.[223] We are seeking feedback on whether amending the accredited investor definition in this manner would provide sufficient investor protections and whether additional limitations on the types or amounts of investments or other conditions may be appropriate if the Commission were to adopt such an approach in expanding the accredited investor definition.

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[221] *See* Concept Release at 30478.

[222] *See, e.g.,* IAA Letter, Artivest Letter, MarketPlus Letter, EquityZen Letter, 2019 SBIA Letter, IPA Letter, BlackRock Letter, and Wefunder Letter.

[223] *See, e.g.,* ICI Letter and PIABA Letter.

Request for Comment

50. Should we maintain the current financial thresholds in the definition of accredited investor and index the thresholds to inflation on a going-forward basis? If so, what would be an appropriate interval to index the thresholds to inflation? For example, should the Commission consider whether adjustment for inflation is appropriate every four years in connection with the Commission's quadrennial review of the accredited investor definition required by the Dodd-Frank Act?

51. Should we make a one-time adjustment to increase the thresholds to take into account some or all of the effects of inflation on the pool of potential accredited investors since adoption? What would be the effects of any such change on investors and issuers? Should we also index the thresholds to inflation on a going-forward basis? Should we consider other approaches such as the recommendation in the 2015 Staff Report to leave the current thresholds for natural persons in place but subject them to investment limits? If so, what investment limits should we consider? What would be the impact of such changes on investors and on the ability of companies to raise capital, particularly small businesses?

52. Should we increase the thresholds to take into account the effects of inflation since adoption, but grandfather investors that currently meet the accredited investor definition with respect to existing investments?

53. Is there any evidence that investor protections provided by the existing thresholds have eroded over time?

54. As noted above and in the Economic Analysis below, income levels vary, sometimes substantially, in different geographic areas of the country. Should we take into account income disparities that may be attributable to different costs of living across the country in establishing financial thresholds in the accredited investor definition? If so, how should we categorize different geographic regions for these purposes and how should we calculate income differences that may be attributable to differences in cost of living?

- For example, should we categorize the regions by state, by county or parish, or by census tract? If we should instead use larger regions, how should those be defined? How often would we need to reconsider how the regions are defined?
- If income disparities that may be due to local differences in the cost of living were taken into account, would the financial thresholds need to be adjusted for certain regions? How would we determine which regions require adjustment? Similarly, how would we determine which regions should maintain the current thresholds?
- If these income disparities that may be due to differences in the local cost of living were taken into account, should we use the United States Office of Personnel Management's general schedule locality areas? Should we use a different adjustment mechanism?
- Should we consider any other changes to the accredited investor definition to address the geographic disparity in the proportion of the population that

qualifies as accredited investors in different regions of the country? If so, what types of changes would be appropriate?

- Would there be difficulties for investors to demonstrate, and issuers to form a reasonable belief about, the varying financial thresholds? How would we address any such difficulties?

55. Would an inflation adjustment on an on-going basis have a disparate impact on certain types of investors, such as those in particular geographic regions or those in specific age ranges?

56. Is there evidence that any fraud in the private markets is driven or affected by the levels at which the accredited investor definition is set, or that maintaining the current financial thresholds would place investors at a greater risk of fraud?

57. Would providing for an inflation adjustment going forward have an impact on the ability of companies to raise capital, particularly small businesses? Would an inflation adjustment going forward have a disparate impact on certain small businesses, such as those in particular geographic regions with lower venture capital activity?

58. Under the current definition, the value of a person's primary residence is excluded from the net worth calculation.[224] Should the Commission consider any changes

[224] Section 413(a) of the Dodd-Frank Act excluded the value of a person's primary residence from the net worth calculation and directed the Commission to adjust similarly any accredited investor net worth standard in its Securities Act rules. In 2011, the Commission revised Rules 215 and 501 to exclude any positive equity that individuals have in their primary residences. *See* Regulation D 2011 Adopting Release. The revised calculation requires that any excess of indebtedness secured by the primary residence over the estimated fair market value of the residence be considered a liability for purposes of determining accredited investor status on the basis of net worth. The Commission also added a 60-day lookback period to prevent investors from artificially inflating their net worth by incurring incremental indebtedness secured by their primary residence, thereby effectively converting their home equity into cash or other assets that would be included in the net worth calculation.

to the rules implementing this requirement? Are there other assets or liabilities that should be excluded from or included in the calculation? Should we consider excluding all or a portion of an individual's retirement accounts when calculating net worth, similar to the exclusion for an individual's primary residence? If so, what percentage of an individual's retirement account should be excluded?

59. If we index the financial thresholds, is CPI-U the appropriate inflation adjustor? 17 CFR 275.205-3(e) under the Advisers Act and certain other Commission rules use as an inflation adjustor the Personal Consumption Expenditures Chain-Type Price Index ("PCE") (or any successor index thereto), as published by the United States Department of Commerce, which is an indicator of inflation in the prices for goods and services paid by persons living in the United States.[225] Should we use PCE instead of CPI-U? Is indexing for inflation the appropriate benchmark? Are there more appropriate benchmarks?

60. If we were to permit an investor advised by a registered investment adviser or broker-dealer to be deemed an accredited investor, under what circumstances would that registered financial professional be likely to recommend investing in a Regulation D offering? What types of investors would be likely to receive a recommendation from that registered financial professional to invest in a Regulation D offering?

61. If an investor is to be considered an accredited investor by virtue of being advised by a registered investment adviser or broker-dealer, should we consider additional investor protections? For example, should such financial professionals have to

[225] *See* https://www.bea.gov/data/personal-consumption-expenditures-price-index.

eliminate any conflicts of interest related to such advice for its advice to render an investor an accredited investor or should such a financial professional have to mitigate such conflicts of interest in a particular way? Should such financial professionals have to conduct any different due diligence before advising the investor on such investments? Should there be limits on the types or amounts of investments that such an investor could make under these circumstances?

IV. PROPOSED AMENDMENT TO THE QUALIFIED INSTITUTIONAL BUYER DEFINITION

Rule 144A provides a non-exclusive safe harbor exemption from the registration requirements of the Securities Act for resales to qualified institutional buyers of certain restricted securities. Any person, other than the issuer or a dealer, who offers or sells securities in compliance with Rule 144A is deemed not to be engaged in a distribution of the securities and therefore not an underwriter of the securities within the meaning of Section 2(a)(11) of the Securities Act, such that the Section 4(a)(1) exemption is available for the resales of the securities.[226] When originally proposing to define a "qualified institutional buyer," the Commission noted that it was "seeking to identify a class of investors that can be conclusively assumed to be sophisticated and in little need of the protection afforded by the Securities Act's registration provisions."[227]

With the exception of registered dealers, a qualified institutional buyer must in the aggregate own and invest on a discretionary basis at least $100 million in securities of

[226] Rule 144A(b).

[227] *See* Resale of Restricted Securities; Changes to Method of Determining Holding Period of Restricted Securities Under Rules 144 and 145, Release No. 33-6806 (Oct. 25, 1988) [53 FR 44016 (Nov. 1, 1988)].

issuers that are not affiliated with that qualified institutional buyer.[228] Under Rule 144A(a)(1)(vi), banks and other specified financial institutions are subject to an additional minimum audited net worth requirement of $25 million.[229] Rule 144A(a)(1)(i) specifies the types of institutions that are eligible for qualified institutional buyer status if they meet this $100 million in securities owned and invested threshold, which include insurance companies; registered investment companies; SBICs; employee benefit plans established and maintained by a state, its political subdivisions, or any agency or instrumentality of a state or its political subdivisions; employee benefit plans within the meaning of Title I of the Employee Retirement Income Security Act (ERISA) of 1974; trust funds whose trustee is a bank or trust company and whose participants are employee benefit plans within the scope of Rule 144A(a)(1)(i)(D) or (E), excluding trust funds that include individual retirement accounts or H.R. 10 plans as participants; business development companies; and registered investment advisers.[230] In addition, Rule 144A(a)(1)(i)(H) sets forth the following types of eligible entities:

- organizations described in Section 501(c)(3) of the Internal Revenue Code;
- corporations (other than a bank as defined in Section 3(a)(2) of the Securities Act or a savings and loan association or other institution referenced in Section 3(a)(5)(A) of the Securities Act or a foreign bank or savings and loan association or equivalent institution);
- partnerships; and

[228] Rule 144A(a)(1)(i). A registered dealer is a qualified institutional buyer if it owns and invests in the aggregate at least $10 million of securities of non-affiliated issuers on a discretionary basis or if it is acting in a riskless principal transaction on behalf of a qualified institutional buyer. Rules 144A(a)(1)(ii) and (iii).

[229] Rule 144A(a)(1)(vi).

[230] Rule 144A(a)(1)(i)(A) – (G) and (I).

- Massachusetts or similar business trusts.

A number of commenters on the Concept Release recommended that the Commission expand the list of entities that are eligible for qualified institutional buyer status. One commenter recommended that the Commission revise the qualified institutional buyer definition to include any entity.[231] Some commenters urged the Commission to expand the qualified institutional buyer definition to encompass additional state and local governmental entities and organizations[232] or non-U.S. entities such as sovereign wealth funds and non-U.S. pension funds that are substantially equivalent to the entities that currently qualify for qualified institutional buyer status.[233] A number of commenters recommended that the Commission permit bank-maintained collective investment trusts that include certain H.R. 10 plans to qualify as qualified institutional buyers[234] and/or allow collective investment trusts to qualify using the "family of investment companies" test available to registered investment companies under Rule 144A(a)(1)(iv).[235]

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[231] *See* PFM Letter.

[232] *See* letter from San Bernardino County Treasury dated September 24, 2019; letter from South Dakota Investment Counsel dated September 24, 2019; and CMTA Letter.

[233] *See* letter from Franklin Resources, Inc. dated September 24, 2019 ("Franklin Templeton Letter") and IAA Letter.

[234] *See* letter from Wilmington Trust, N.A. dated September 24, 2019; BlackRock Letter (also recommending that bank maintained common trust funds that include H.R. 10 plans similarly qualify); letter from Coalition of Collective Investment Trusts dated September 24, 2019; letter from Fidelity Investments dated September 24, 2019; Franklin Templeton Letter; and letter from American Bankers Association dated September 24, 2019 ("Am. Bankers Assn. Letter"). A number of these commenters noted that an H.R. 10 plan (also known as a "Keough plan") may qualify as a qualified institutional buyer in its own right under Rule 144A(a)(1)(i)(E) if it meets the applicable conditions but that a collective investment trust that includes such an H.R. 10 plan as a participant would not be eligible for qualified institutional buyer status under Rule 144A(a)(1)(i)(F).

[235] *See* SIFMA Letter; Franklin Templeton Letter; Shartsis Friese Letter; and Am. Bankers Assn. Letter (also recommending that bank maintained common trust funds qualify under the same test).

One commenter urged the Commission to clarify that the term "similar business trust" under Rule 144A(a)(1)(i)(H) includes central managed trusts that otherwise qualify under the definition which are managed by a foreign or domestic bank or a professional investment manager that itself qualifies as a qualified institutional buyer.[236] Another commenter recommended that the Commission adopt a calculation method based on fair market value, rather than cost basis, in determining the aggregate value of securities owned and invested for purposes of Rule 144A(a)(3).[237] Two commenters stated that the Commission should consolidate the qualified institutional buyer definition with other definitions.[238]

In light of these concerns and to avoid inconsistencies between the entity types that are eligible for accredited investor status and qualified institutional buyer status, we propose to expand the qualified institutional buyer definition by making conforming changes to Rule 144A(a)(1)(i)(C) and the list of entities in Rule 144A(a)(1)(i)(H) to correspond to the proposed amendments to Rule 501(a)(1) and Rule 501(a)(3). Specifically, we propose to add RBICs to Rule 144A(a)(1)(i)(C) and limited liability companies to Rule 144A(a)(1)(i)(H). Further, to ensure that entities that qualify for accredited investor status may also qualify for qualified institutional buyer status when they meet the $100 million in securities owned and invested threshold in

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[236] *See* ICI Letter.

[237] *See* Shartsis Friese Letter.

[238] *See* letter from CompliGlobe Ltd. dated September 24, 2019 (recommending that the Commission consolidate the definitions of qualified purchaser, qualified investor, qualified institutional buyer, major U.S. institutional investor, and U.S. institutional investor into a single new definition) and letter from William J. Williams, Jr. dated September 25, 2019 (recommending that the Commission adopt a consolidated and simplified version of Rules 506, 144, and 144A that would limit sales to eligible purchasers).

Rule 144A(a)(1)(i), we propose to add new paragraph (J) to Rule 144A(a)(1)(i) that would permit institutional accredited investors under Rule 501(a), of an entity type not already included in paragraphs 144A(a)(1)(i)(A) through (I) or 144A(a)(1)(ii) through (vi), to qualify as qualified institutional buyers when they satisfy the $100 million threshold.[239] This new category in the qualified institutional buyer definition would encompass the proposed new category in the accredited investor definition for entities owning investments in excess of $5 million that are not formed for the specific purpose of acquiring the securities being offered under Regulation D,[240] as well as any other entities that may be added to the accredited investor definition in the future, but such entities would also have to meet the $100 million threshold in order to be qualified institutional buyers under Rule 144A.

We believe that these proposed changes would expand the qualified institutional buyer definition to encompass all of the entity types suggested by commenters on the Concept Release, so long as these entities meet the $100 million threshold in Rule 144A(a)(1)(i).[241] The $100 million threshold for these entities to qualify for qualified institutional buyer status should ensure that these entities have the financial sophistication and access to resources such that they do not need the protections of registration under the Securities Act. Eligible purchasers under Rule 144A(a)(1)(i) would

[239] Because proposed Rule 144A(a)(1)(i)(J) would cover entities not included in paragraphs (A) through (I), a bank or other financial institution specified in those paragraphs would continue to be required to satisfy the net worth test in Rule 144A(a)(vi).

[240] Proposed Rule 501(a)(9).

[241] For example, proposed Rule 144A(a)(1)(i)(J) would encompass bank-maintained collective investment trusts that include as participants individual retirement accounts or H.R. 10 plans that are currently excluded from the qualified institutional buyer definition pursuant to Rule 144A(a)(1)(i)(F), so long as the collective investment trust satisfies the $100 million threshold.

continue to include entities formed solely for the purpose of acquiring restricted securities under Rule 144A, provided that they satisfy the test for qualified institutional buyer status.[242]

Request for Comment

62. Should Rule 144A(a)(1)(i)(C) be amended to include RBICs in a manner consistent with the proposed amendments to Rule 501(a)(1)? Should Rule 144A(a)(1)(i)(H) be amended to include limited liability companies in a manner consistent with Rule 501(a)(3)? Rather than, or in addition to, amending Rule 144A in this manner, should we add other types of entities to those currently in Rule 144A(a)(1)(i)? Are there any categories of entities included in the proposed amendment to Rule 501(a) that should not be included in the definition of qualified institutional buyer under Rule 144A?

63. Should we add a new paragraph (J) to Rule 144A(a)(1)(i) to expand the list of entities eligible to be qualified institutional buyers to include institutional accredited investors under Rule 501(a) that meet the $100 million in securities owned and invested threshold and that are an entity type not already included in paragraphs 144A(a)(1)(i)(A) through (I) or 144A(a)(1)(ii) through (vi)? Are there any types of entities that should be included under new paragraph (J) that would be excluded because of the limitation that these additional entity types may not include entities otherwise listed in existing paragraphs (a)(1)(i) through (vi) of Rule 144A? To the extent that there is overlap between the types of entities listed

[242] This is in contrast to the proposed amendment to the accredited investor definition in Rule 501(a)(3), which would continue to require that the entity not be formed for the specific purpose of acquiring the securities offered.

in the accredited investor definition and those listed in the qualified institutional buyer definition, would adding new paragraph (J) render existing paragraphs (A) through (I) under Rule 144A(a)(1)(i) unnecessary?

64. Are there certain types of entities that are less likely to have experience in the private resale market for restricted securities and may have more need for the protections afforded by the Securities Act's registration provisions? Are there concerns about amending the definition of "qualified institutional buyer" to encompass an expanded list of entities in Rule 144A(a)(1)(i) that meet the $100 million in securities owned and invested threshold?

65. If we were to expand the definition of qualified institutional buyer in this manner, would there be a greater likelihood of restricted securities sold under Rule 144A flowing into the public market? If so, should we consider additional modifications to Rule 144A to address this possibility?

V. IMPLICATIONS FOR OTHER CONTEXTS

In addition to its central role in offerings conducted under Regulation D, the accredited investor definition plays an important role in other areas of federal securities law and in other contexts. To assist the Commission in more fully understanding the implications of amending the accredited investor definition, we are soliciting comment on the implications of the proposed amendments for these other contexts.

An issuer that is not a bank, a savings and loan holding company, or a bank holding company must register a class of equity securities under Exchange Act Section 12(g) and become an reporting company under the Exchange Act if, on the last day of its fiscal year, it has total assets of more than $10 million and the class of equity

securities is held of record by either (i) 2,000 or more persons, or (ii) 500 or more persons who are not accredited investors as defined in Rule 501(a).[243] Under existing rules, a non-reporting issuer must analyze at its fiscal year end whether its total assets and the number of its record holders meet these thresholds in determining whether it must commence reporting under the Exchange Act. For Section 12(g) purposes, the determination of accredited investor status must be made as of the last day of the issuer's most recent fiscal year rather than at the time of the sale of the securities.[244] As stated above, the accredited investor definition in Rule 501(a) includes a reasonable belief standard, such that any person who comes within one or more of the categories in the definition, or whom the issuer reasonably believes comes within such category or categories, is deemed to be an accredited investor.[245] To the extent that non-reporting issuers sell securities to individuals or entities that qualify for accredited investor status under the proposed new categories in the definition, new issues and complexities in establishing a reasonable belief as to whether these individuals or entities are accredited investors as of a fiscal year end may be introduced to the Section 12(g) year-end analysis. Depending on the circumstances, this could result in complex and time-consuming determinations by issuers as of a subsequent fiscal year end if they sell securities to such individuals or entities. On the other hand, these issuers may be able to remain under the Section 12(g) thresholds and avoid having to register a class of equity securities under

[243] 15 U.S.C. 78l(g) and 17 CFR 240.12g-1 under the Exchange Act ("Rule 12g-1"). See Changes to Exchange Act Registration Requirements to Implement Title V and Title VI of the JOBS Act, Release No. 33-10075 (May 3, 2016) [81 FR 28689 (May 10, 2016)] ("Changes to Exchange Act Registration Requirements Release").

[244] Rule 12g-1(b)(1) under the Exchange Act.

[245] Whether an issuer has a reasonable belief depends on the particular facts and circumstances of the determination.

Section 12(g) for a longer period if they are able to sell securities to an expanded pool of accredited investors and to fewer non-accredited investors.

Regulation A limits the amount of securities that a person who is not an accredited investor can purchase in an offering conducted under Tier 2 of Regulation A when the issuer's securities are not listed on a national securities exchange to no more than 10 percent of the greater of annual income or net worth (for natural persons), or 10 percent of the greater of annual revenue or net assets at fiscal year-end (for entities).[246] As a result of the proposed amendments to the accredited investor definition, a wider pool of accredited investors would not be subject to these investment limits applicable to non-accredited investors, which could lead to more investor interest in Tier 2 offerings under Regulation A.

In addition, some states use the accredited investor definition to determine whether investment advisers to certain private funds must be registered with the state[247] or incorporate the definition in a range of other contexts.[248] Further, under Rule 504 of Regulation D, issuers are permitted to use general solicitation or general advertising to offer and sell securities when the offers and sales are made (i) pursuant to state law

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[246] See 17 CFR 230.251(d)(2)(i)(C).

[247] *See*, *e.g.*, Final Order Granting Exemption From the Registration Requirements for Investment Advisers to Private Funds and Their Investment Adviser Representatives, Wisconsin Department of Financial Institutions, Division of Securities (Feb. 17, 2012); Certificate Exemption for Investment Advisers to Private Funds, Cal. Code Regs. Title 10 § 260.204.9; and Sixth Transition Order administering the Michigan Uniform Securities Act, State of Michigan Department of Energy, Labor & Economic Growth, Office of Financial and Insurance Regulation (Mar. 11, 2011).

[248] *See*, *e.g.*, Cal. Gov't Code § 64111 (government finance); Cal. Fin. Code § 22064 (finance lending); Fla. Stat. §§ 494.001 and 494.00115 (mortgage lending); Tex. Ins. Code § 1111A.002 (insurance); and Conn. Gen. Stat. § 36a-2 (2014) (financial institution regulation).

exemptions from registration that permit general solicitation and general advertising and (ii) sales are made only to accredited investors as defined in Rule 501(a).[249]

Finally, any changes to the accredited investor definition may have an impact on the use of the Rule 506(c) exemption, which requires issuers to take reasonable steps to verify the accredited investor status of purchasers in the offering. To the extent that it may be difficult for issuers to comply with the verification requirement in Rule 506(c) with respect to new or modified categories of accredited investors, issuers may be reluctant to, or determine not to, sell securities to these investors in Rule 506(c) offerings. Conversely, to the extent that the verification requirement presents fewer difficulties for new or modified categories of accredited investors, for example, natural persons with certain professional certifications or designations that are more readily verifiable, issuers may be more willing to sell securities in Rule 506(c) offerings to these investors.

Request for Comment

66. Would the proposed new categories of accredited investors and the proposed modifications to the existing standards present issues for non-reporting issuers in determining whether individuals and entities that meet the accredited investor definition at the time of purchase continue to be accredited investors as of the end of a fiscal year for the purposes of Exchange Act Rule 12g-1?

67. Would expanding the accredited investor definition to encompass the proposed new categories of accredited investors, such as persons with certain professional certifications or designations or knowledgeable employees of private funds, raise

[249] Rule 504(b)(1)(iii).

concerns under state law provisions that incorporate the Rule 501(a) accredited investor definition? If so, what are those concerns?

68. Would the proposed amendments to the accredited investor definition give rise to issues under Rule 504 when issuers engage in general solicitation or general advertising to offer and sell securities pursuant to state law exemptions from registration that permit general solicitation and general advertising when sales are made only to accredited investors? If so, what are those issues?

69. Would there be concerns about meeting the verification requirement in Rule 506(c) with respect to the proposed new categories of accredited investors or the modifications to the existing categories in the definition? If so, what are those concerns? Would amending the accredited investor definition in this manner make it more likely or less likely that an issuer would conduct a Rule 506(c) offering?

VI. GENERAL REQUEST FOR COMMENT

We request and encourage any interested person to submit comments regarding the proposed rule amendments, specific issues discussed in this release, and other matters that may have an effect on the proposed rule amendments. With regard to any comments, we note that such comments are of particular assistance to our rulemaking initiative if accompanied by supporting data and analysis of the issues addressed in those comments.

VII. ECONOMIC ANALYSIS

A. Introduction

The Commission is proposing to amend the "accredited investor" definition in Rule 501(a) of Regulation D by: (1) adding new categories in the definition that would

permit natural persons to qualify as accredited investors based on certain professional certifications or designations or other credentials, or with respect to investments in a private fund, as a "knowledgeable employee" of the private fund; (2) adding certain entity types to the current list of entities that may qualify as accredited investors and a new category for any entity with "investments," as defined in Rule 2a51-1(b) under the Investment Company Act, in excess of $5 million and that was not formed for the specific purpose of investing in the securities offered; (3) adding family offices with at least $5 million in assets under management and their family clients to the definition; (4) adding the term "spousal equivalent" to the definition, so that spousal equivalents may pool their finances for the purpose of qualifying as accredited investors; and (5) codifying certain staff interpretive positions that relate to the accredited investor definition. The Commission is also proposing to amend the definition of "qualified institutional buyer" in Rule 144A to expand the list of entities that are eligible to qualify as qualified institutional buyers.

We are attentive to the costs imposed by and the benefits obtained from the proposed amendments. Section 2(b) of the Securities Act[250] and Section 3(f) of the Exchange Act[251] require us, when engaging in rulemaking that requires us to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation. Additionally, Section 23(a)(2) of the Exchange Act[252] requires us, when making rules or regulations under the Exchange Act, to consider,

[250] 15 U.S.C. 77b(b).

[251] 15 U.S.C. 78c(f).

[252] 17 U.S.C. 78w(a)(2).

among other matters, the impact that any such rule or regulation would have on competition and states that the Commission shall not adopt any such rule or regulation which would impose a burden on competition that is not necessary or appropriate in furtherance of the Exchange Act.

The discussion below addresses the potential economic effects of the proposed amendments, including the likely benefits and costs, as well as the likely effects on efficiency, competition, and capital formation. Where possible, we have attempted to quantify the benefits, costs, and effects on efficiency, competition, and capital formation expected to result from the proposed amendments. In many cases, however, we are unable to quantify the economic effects because we lack the information necessary to derive a reasonable estimate. For example, we are unable to quantify, with precision, the costs to issuers and investors of verifying an investor's accredited investor status and the potential capital raising and compliance cost savings that may arise from the proposed amendments to the accredited investor definition.

B. Broad Economic Effects

Overall, because the accredited investor definition is an important component of several exemptions from registration, including Rules 506(b) and 506(c) of Regulation D, we expect that the proposed amendments, by expanding the pool of accredited investors, would improve the ability of issuers to raise capital in the exempt markets and reduce competition among issuers for investors, thus reducing the cost of capital. Further, the proposed amendments would permit issuers to engage in test-the-waters communications in registered offerings with a larger set of investors as a result of changes to the definition of institutional accredited investors and qualified institutional buyers. Similarly, the

proposed amendments to the qualified institutional buyer definition in Rule 144A would increase the number of entities that qualify for this status, thus improving the ability of issuers to raise capital and enhancing competition among investors in this market.[253]

The proposed amendments also would impact investors, permitting investors with different attributes of financial sophistication to participate in investment opportunities that are often not available to non-accredited investors, such as investments in issuers that are not Exchange Act reporting companies, and offerings by certain private equity funds, venture capital (VC) funds, and hedge funds, which are frequently offered under Rule 506.[254] Additionally, accredited investors are not subject to investment limits in offerings made under Tier 2 of Regulation A. Thus, expanding the definition of accredited investor would permit additional investors to participate in these offerings at higher amounts, subject to the $50 million offering limit.

The accredited investor concept in Regulation D was designed to identify—with bright-line standards—a category of investors who do not need the protections of registration under the Securities Act.

The accredited investor definition uses income and net worth thresholds to identify natural persons as accredited investors. The Commission established the $200,000 individual income and $1 million net worth threshold in 1982 and the $300,000 joint income threshold in 1988 and has not updated them since, with the exception of

[253] Although Rule 144A is a non-exclusive safe harbor for resale transactions, market participants have used Rule 144A since its adoption in 1990 to facilitate capital raising by issuers. *See, e.g.*, Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings, Release No. 33-9415 (July 10, 2013) [78 FR 44771 (July 24, 2013)].

[254] *See supra* Section II.A.

amending the net worth standard to exclude the value of the investor's primary residence in 2011. According to data from the SCF, we estimate the number of U.S. households that qualify as accredited investors has grown from being approximately 2% of the population of U.S. households in 1983 to 13% in 2019 as a result of inflation.[255]

Regulation D also designates certain entities as accredited investors. Some entities, including but not limited to banks, savings and loan associations, registered broker-dealers, insurance companies, and investment companies registered under the Investment Company Act qualify as accredited investors based on their status alone. Other entities may qualify as accredited investors based on a combination of their status and the amount of their total assets.

While the effects of inflation have expanded the pool of accredited investors, we are not aware from our enforcement experience or otherwise of disproportionate fraud in this expanded space.

We are mindful that it is difficult to reach rigorous conclusions about the typical magnitude of investor gains and losses in exempt offerings. Therefore, it is difficult to determine definitively how the benefits to accredited investors of expanded access to the exempt market compare to the loss of protections provided by registration. While having an expanded set of investment opportunities in private markets can potentially help investors to make more efficient investment decisions, other factors—such as information asymmetry, illiquidity, and prevailing market practices—can nevertheless limit investors'

[255] *See* https://www.federalreserve.gov/econresdata/scf/scfindex.htm. For this analysis, we use the same methodology and variable definitions as Table 4, and we exclude the value of a household's primary residence when measuring net worth. *See supra* note 207. We estimate the number of U.S. households, rather than individuals, that qualify as accredited investors due to data limitations because the database underlying our analysis measures wealth and income at the household level. *See supra* Section III.

opportunity set for private markets. For example, as discussed below, given the presumed financial sophistication of accredited investors, issuers may rely on Rule 506(b) and Rule 506(c) to offer securities on an unregistered basis to accredited investors without providing additional disclosure to those investors.

The proposed amendments could increase the size and alter the composition of the pool of accredited investors by providing additional measures of financial sophistication (*e.g.*, professional certifications for individuals and an investments-owned threshold for entities) to qualify for accredited investor status. If many individuals that would qualify as accredited investors under the proposed amendments already meet the income and wealth thresholds in the current accredited investor definition, then the impact of the change on the pool of individuals that qualify as accredited investors could be limited. However, for entities, we anticipate that the impact of the proposed amendments could be more significant, as we are proposing to amend the accredited investor definition to include a broad range of entities that are not covered under the current definition. Since we believe family offices have generally qualified as accredited investors under the existing definition, we expect that the effect of the amendments on them would be much smaller than on other entities.

We anticipate that the additional investors we propose to designate as accredited investors would have the resources and financial sophistication to assess private investment opportunities, despite the fact that these investments may have unique risk profiles and limited disclosure requirements. For example, investors in Regulation D offerings can be subject to investment risks not associated with registered offerings because (i) some securities law liability provisions do not apply to private offerings,

(ii) issuers of securities in these offerings generally are not required to provide information comparable to that included in a registration statement, and (iii) Commission staff does not review any information that may be provided to investors in these offerings.[256]

Such risks are mitigated for accredited investors that participate in Regulation A offerings because they have access to information comparable to that accompanying registered offerings—*e.g.*, publicly available offering circulars on Form 1-A (for both Tier 1 and Tier 2 offerings), ongoing reports on an annual and semiannual basis (Tier 2 offerings), and additional requirements for interim current event updates (Tier 2 offerings). Additionally, Commission staff reviews Forms 1-A and the test-the-waters materials that issuers file in connection with Regulation A offerings.

Generally, we believe any additional risk of accredited investors experiencing harm in the capital markets as a result of the proposed amendments likely would be limited because the proposed amendments are intended to more effectively identify individuals and entities that do not need the protections rendered by registration under the Securities Act.

We believe the proposed amendments would improve capital formation by providing issuers with an expanded pool of accredited investors and additional avenues—in certain circumstances—to verify an investor's accredited investor status, while likely having a minimal impact on issuers' compliance costs. In 2018, the estimated amount of capital reported as being raised in Rule 506 offerings was $1.7 trillion,[257] which was

[256] *See* 2015 Staff Report.

[257] *See* Concept Release at 30466.

larger than the $1.4 trillion raised in registered offerings.[258] As private capital markets have grown, the vast majority of the capital that has been raised in unregistered offerings under Regulation D has been through investment by accredited investors. For example, though securities sold in offerings conducted pursuant to Rule 506(b) are permitted to be purchased by up to 35 non-accredited investors who are sophisticated, we estimate that, from 2013 to 2018, only 6% of the offerings conducted under Rule 506(b) included non-accredited investor purchasers.[259]

By increasing potential access to private markets and providing issuers with additional tests for accredited investor status that are objective and therefore readily verifiable (*e.g.*, professional certifications and investment tests), the proposed amendments may make unregistered offerings more attractive to certain issuers and particularly facilitate small business capital formation. For example, while the aggregate amount of capital raised through Rule 506 offerings in 2018 ($1.7 trillion) is large, the median offering size was only $1.7 million, indicating that offerings in the Regulation D market typically involve relatively small issues, which is consistent with these offerings being undertaken by smaller and growth-stage firms. Unregistered offerings also can be

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[258] *See id.* at 30465.

[259] DERA staff analysis is based on Form D filings from 2013 to 2018. These estimates are based on the reported "total amount sold" at the time of the original filing—required within 15 days of the first sale—as well as any additional capital raised and reported in amended filings. The data likely underreport the actual amount sold due to two factors. First, underreporting could occur in all years because Regulation D filings can be made prior to the completion of the offering, and amendments to reflect additional amounts sold generally are not required if the offering is completed within one year and the amount sold does not exceed the original offering size by more than 10%. Second, Rule 503 requires the filing of a notice on Form D, but filing a Form D is not a condition to claiming a Regulation D safe harbor or exemption. Hence, it is possible that some issuers do not file a Form D for offerings relying on Regulation D. Finally, in their annual amendments, some funds appear to report net asset values for total amount sold under the offering. Net asset values could reflect fund performance as well as new investment into, and redemptions from, the fund. For these reasons, based on Form D data, it is not possible to distinguish between the two impacts.

important for these issuers, as a significant share of businesses that establish new funding relationships continue to experience unmet credit needs.[260] According to one survey, approximately 64% of small businesses relied on personal or family savings, compared to 0.5% receiving venture capital.[261] In addition, small businesses owned by underrepresented minorities faced significantly higher hurdles in obtaining external financing, which suggests that these businesses may particularly benefit from amendments intended to facilitate private market capital raising.[262] Similarly, businesses located in states or regions with a lower cost of living may uniquely benefit from the proposed amendments as the pool of accredited investors may be smaller in such states or regions. Recent research has examined the importance of the pool of accredited investors for the entry of new businesses and employment and finds that geographic areas experiencing a larger reduction in the number of potential accredited investors experienced negative effects on new firm entry and employment levels at small entrants.[263]

Lastly, we expect that the proposed amendments could have an impact on the market for registered offerings. It is possible that newly accredited investors shift capital away from registered offerings and towards unregistered offerings. Such a switch of

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[260] *See* 2015 Staff Report.

[261] *See* 2019 Kauffman Foundation Access to Capital for Entrepreneurs: Removing Barriers, *available at* https://www.kauffman.org/-/media/kauffman_org/entrepreneurship-landing-page/capital-access/capitalreport_042519.pdf. The study relies on the data from the 2016 Annual Survey of Entrepreneurs, released in August 2018.

[262] *See id*.

[263] *See* Laura Lindsey & Luke C.D. Stein, *Angels, Entrepreneurship, and Employment Dynamics: Evidence from Investor Accreditation Rules* (Working Paper, 2019) ("Lindsey & Stein (2019)"). This study examines the effects on angel finance stemming from the Dodd-Frank Act's elimination of the value of the primary residence in the determination of net worth for purposes of accredited investor status.

investment focus could decrease the amount of capital flowing into registered offerings and hence negatively affect registered issuers. Due to lack of data, we are unable to quantify the magnitude of such a potential impact. It is also conceivable that newly accredited investors do not change their investment allocations to the registered offerings market but instead increase investments in unregistered offerings by diverting capital from other investment opportunities (*e.g.*, savings, real estate). In this case, we would not expect any significant effect on the market for registered offerings. We cannot determine how likely each of these scenarios is.

The remainder of this economic analysis presents the baseline; anticipated benefits and costs from the proposed amendments; potential effects on efficiency, competition, and capital formation; and alternatives to the proposed amendments.

C. Baseline and Affected Parties

The main affected parties of the proposed amendments to the accredited investor definition would be investors and issuers. For example, certain non-accredited investors, such as entities that are currently not designated accredited investors, would become accredited investors under the proposed amendments and be able to participate in an expanded array of private offerings. Correspondingly, current accredited investors may have to compete more intensively to participate in investment opportunities in this market. Similarly, we anticipate that certain issuers, such as issuers that are smaller or in early stages of development, would need to compete less intensively to solicit accredited investors under the proposed amendments.

We are not able to directly estimate the number of current accredited investors that would be affected by the proposed amendments as precise data on the number of

individuals and entities that currently qualify as accredited investors are not available to us. As noted above, Rule 501(a) of Regulation D uses net worth and income as bright-line standards to identify natural persons as accredited investors.[264]

Using data on household wealth from the SCF database, we estimate that under the current income and wealth thresholds noted above, approximately 16.0 million U.S. households, representing 13% of the total population of U.S. households, qualify as accredited investors. The data provides an estimate of the overall pool of households that qualify as accredited investors in the United States. This estimate does not, however, identify the precise number of accredited investors that do or would invest in the Regulation D market or in other exempt offerings.[265]

Based on Form D filings during the period 2009-2018, we estimate that there were on average approximately 293,700 accredited investors participating annually in Regulation D offerings.[266] However, because an investor can participate in more than one Regulation D offering, this aggregation likely overstates the actual number of unique investors, and we lack data to estimate the extent of overlap. Additionally, from the information reported on Form D, we do not have the ability to distinguish accredited investors that are natural persons from accredited investors that are institutions.[267] The

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[264] Under the current definition, individuals may qualify as accredited investors if (i) their net worth exceeds $1 million (excluding the value of the investor's primary residence), (ii) their income exceeds $200,000 in each of the two most recent years, or (iii) their joint income with a spouse exceeds $300,000 in each of those years and the individual has a reasonable expectation of reaching the same income level in the current year.

[265] Form D data and other data available to us on private placements do not allow us to estimate the number of unique accredited investors that participate in exempt offerings.

[266] We estimate the number of accredited investors as the number of total investors minus the number of non-accredited investors reported on Form D.

[267] Other limitations of the data gathered from Form D may reduce the accuracy of the estimated number of accredited investors. For example, an issuer is required to file a Form D generally no later than 15

average number of accredited investors per offering during the period 2009-2018 was 14, and the median number was four.

Table 6 presents evidence on investor participation in Regulation D offerings by industry type during the period 2009-2018. The participation of accredited investors in Regulation D offerings during that period varied by type of issuer as well, with offerings by real estate investment trusts (REITs) having the largest average number of accredited investors per offering, and those by operating companies having the smallest average number.

Table 6. Investors participating in Regulation D offerings: 2009-2018

	Total Number of Investors*	Mean Investors per Offering	Median Investors per offering	Fraction of offerings with one or more non-accredited investor
Hedge Fund	30,264	16	2	7%
Private Equity Fund	26,518	18	3	3%
Venture Capital Fund	8,806	14	3	1%
Other Investment Fund	36,651	22	6	4%
Financial Services	12,097	15	4	12%
Real Estate	67,532	26	8	13%
Non-financial Issuers	165,606	10	4	9%
All offerings	301,286	14	4	9%

**2009-2017 data is annualized*

We are not able to directly estimate the number of individuals who may newly qualify as accredited investors as a result of the proposed professional certifications or designations as precise data on the number of current holders of each professional

calendar days after the first sale of securities in a Regulation D offering, regardless of whether the offering will be ongoing after the filing of the Form D. Further, issuers are required to file amendments to Form D only in limited circumstances: (i) to correct a material mistake of fact or error in a previously filed Form D, (ii) to reflect a change in certain information provided in a previously filed Form D, and (iii) on an annual basis if the offering is continuing at that time. Also, because the Form D filing requirement is not a condition to claiming an exemption under Rule 506(b) or 506(c) but rather is a requirement of Regulation D, it is possible that some issuers do not file Form D when conducting Regulation D offerings.

certification or designation are not available to us. According to data on state-registered investment advisers compiled by NASAA, there were 17,543 registered investment advisers as of December 2018.[268] Based on data from FINRA, we estimate that there were 691,041 FINRA-registered individuals as of December 2018.[269] We estimate that 334,860 individuals were registered as only broker-dealers; 294,684 were dually registered as broker-dealers and investment advisers; and 61,497 were registered as only investment advisers. However, because FINRA-registered representatives can hold multiple professional certifications, this aggregation likely overstates the actual number of individuals that hold a Series 7 or Series 82, and we have no method of estimating the extent of overlap.

We are not able to directly estimate the number of knowledgeable employees at private funds that would be immediately affected by the proposed amendments as precise data on the number of knowledgeable employees of private funds are not available to us. Using data on private fund statistics compiled by the Commission's Division of Investment Management, we estimate that there were 32,202 private funds as of fourth quarter 2018.[270]

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[268] *See* 2019 NASAA Investment Adviser Section Annual Report, *available at* https://www.nasaa.org/wp-content/uploads/2019/06/2019-IA-Section-Report.pdf.

[269] *See* 2019 FINRA Industry Snapshot, *available at* https://www.finra.org/sites/default/files/2019%20Industry%20Snapshot.pdf.

[270] *See* U.S. Securities and Exchange Commission, Division of Investment Management Fourth Quarter 2018 Private Fund Statistics, *available at* https://www.sec.gov/divisions/investment/private-funds-statistics/private-funds-statistics-2018-q4.pdf.

Industry observers have estimated that there are 2,500 to 3,000 single family offices managing more than $1.2 trillion in assets.[271] We lack data to determine the number of family clients of family offices.

When identifying entities as accredited investors, the current definition enumerates specific types of entities that would qualify. Certain enumerated entities are subject to a $5 million asset threshold to qualify as accredited investors (*e.g.*, tax-exempt charitable organizations, trusts, and employee benefit plans), while others are not (*e.g.*, banks, insurance companies, registered broker-dealers, entities in which all equity owners are accredited investors, private business development companies, and SBICs). Many of the entities that are not subject to asset tests are regulated entities. An entity that is not covered specifically by one of the enumerated categories, such as an Indian tribe or sovereign wealth fund, is generally not an accredited investor under the current rule.

Publicly reported information provides an indication of the number of entities, by type, that may currently qualify as accredited investors. There were 3,764 broker-dealers that filed FOCUS reports with the Commission for 2018. As of 2018, there were 4,715 FDIC-insured banks, 691 savings and loan institutions,[272] and 305 SBICs.[273] There were 104 business development companies (BDCs) as of December 31, 2018.[274] There were

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[271] *See* Pamela J. Black, *The Rise of the Multi-Family Office*, FINANCIAL PLANNING (Apr. 27, 2010), https://www.financial-planning.com/news/the-rise-of-the-multi-family-office. A single family office generally provides services only to members of a single family.

[272] *See* FDIC Statistics at a Glance as of June 30, 2019, *available at* https://www.fdic.gov/bank/statistical/stats/2019jun/fdic.pdf.

[273] *See* Small Business Administration (SBA) SBIC Program Overview as of March 31, 2019, *available at* https://www.sba.gov/sites/default/files/2019-05/SBIC%20Quarterly%20Report%20as%20of%20March%2031%202019_0.pdf.

[274] *See* Securities Offering Reform for Closed-End Investment Companies, Release No. 33–10619 (Mar. 10, 2019) [84 FR 14448 (Apr. 10, 2019)].

5,954 insurance companies as of 2017.[275] With respect to the proposed amendments to the accredited investor definition to add other types of institutional accredited investors, there were 13,429 registered investment advisers as of 2018 and approximately 17,500 state-registered investment advisors.[276] However, we lack data to generate precise estimates of the overall number of other institutional accredited investors because disclosure of accredited investor status across all institutional investors is not required and because, while we have information to estimate the number of some categories of institutional accredited investors, we lack comprehensive data that will allow us to estimate the unique number of investors across all categories of institutional accredited investors under Rule 501(a).

We also lack data to directly estimate the number of small private firms that would be potential issuers under the proposed amendments.

Based on analysis of Form D filings, we have identified approximately 134,345 unique issuers (of which the majority were non-fund issuers) that have raised capital through Regulation D offerings from 2009 until 2017. These issuers would benefit from the expansion of the accredited investor pool under the proposed amendments. Additionally, newer issuers could be drawn to the Regulation D market by the expanded pool of accredited investors as a result of the proposed amendments.

[275] *See* Insurance Information Institute Industry Overview, *available at* https://www.iii.org/fact-statistic/facts-statistics-industry-overview#Insurance.

[276] Identified from Form ADV and FINRA data.

Table 7. Frequency of Regulation D offerings by unique issuers: 2009-2018

Number of Offerings	**Non-Fund Issuers**		**Fund Issuers**		**All Regulation D Issuers**
	Number of Issuers	Proportion	Number of Issuers	Proportion	
1	71,452	75.7%	49,822	95.5%	121,274
2	11,418	12.1%	1,733	3.3%	13,151
3	4,868	5.2%	299	0.6%	5,167
4	2,620	2.8%	116	0.2%	2,736
5	1,528	1.6%	46	0.1%	1,574
6 or more Offerings	2,511	2.6%	124	0.3%	2,635
Total: Unique Issuers	**94,397**		**52,140**		**146, 537**

Lastly, the proposed amendments to the accredited investor definition likely would impact the market for private offerings in terms of increased capital raising. As noted above, accredited investors play a prominent role in Regulation D offerings. As Table 8 shows, in 2018, issuers in the Regulation D market raised approximately $1.7 trillion. The vast majority of capital raised in this market was raised under Rule 506(b), which has no limit on the number of purchasers who are accredited investors and limits the number of non-accredited investors to 35 per offering. Offerings under Rule 506(c), under which purchasers are exclusively accredited investors, raised approximately $211 billion. The largest amount of capital raised in other exempt offerings, approximately $1.2 trillion, came from Rule 144A offerings.[277] The total amount of capital raised in the Regulation A market was approximately $736 million in 2018.

[277] The term "Rule 144A offering" refers to a primary offering of securities by an issuer to one or more financial intermediaries (commonly known as the "initial purchasers") in a transaction exempt from registration under the Securities Act, followed by the immediate resale of the securities by the initial purchasers to qualified institutional buyers in reliance on Rule 144A.

Table 8: Overview of amounts raised in the exempt market in 2018[278]

Exemption	Amounts Reported or Estimated as Raised in 2018
Rule 506(b) of Regulation D	$1.5 trillion
Rule 506(c) of Regulation D	$211 billion
Regulation A: Tier 1	$60.5 million
Regulation A: Tier 2	$675.3 million
Rule 504 of Regulation D	$2 billion
Other exempt offerings[279]	$1.2 trillion

D. Anticipated Economic Effects

In this section, we discuss the anticipated economic benefits and costs of the proposed amendments to the accredited investor definition. Issuers and investors in unregistered offerings are the parties expected to be most affected by the proposed amendments. We first analyze the potential costs and benefits of the proposed

[278] Data on Regulation D capital raising is taken from Form D and Form D/A filings. Information on Regulation A capital raising is taken from Form 1-A and Form 1-A/A filings.

[279] "Other exempt offerings" are identified from Regulation Crowdfunding, Regulation S, and Rule 144A offerings. The data used to estimate the amounts raised in 2018 for other exempt offerings includes data on:

- offerings under Section 4(a)(2) of the Securities Act that were collected from Thomson Financial's SDC Platinum, which uses information from underwriters, issuer websites, and issuer SEC filings to compile its Private Issues database;
- offerings under Regulation Crowdfunding that were collected from Form C filings on EDGAR. For offerings that have been amended, the data reflects information reported in the latest amendment as of the end of the considered period. Regulation Crowdfunding requires an issuers to file a progress update on Form C-U within 5 business days after reaching 100% of its target offering amount. The data on Regulation Crowdfunding excludes withdrawn offerings. Some withdrawn offerings may be failed offerings. Amounts raised may be lower than the target or maximum amounts sought.
- offerings under Regulation S that were collected from Thomson Financial's SDC Platinum service; and
- resale offerings under Rule 144A that were collected from Thomson Financial SDC New Issues database, Dealogic, the Mergent database, and the Asset-Backed Alert and Commercial Mortgage Alert publications to further estimate the number of exempt offerings under Section 4(a)(2) and Regulation S. We included amounts sold in Rule 144A resale offerings because those securities are typically issued initially in a transaction under Section 4(a)(2) or Regulation S but generally are not included in the Section 4(a)(2) or Regulation S data identified above.

These amounts are accurate only to the extent that these databases are able to collect such information and may understate the actual amount of capital raised under these offerings if issuers and underwriters do not make this data available.

amendments for each of these affected parties and then discuss how those effects may vary based on the characteristics of issuers and investors.

1. Potential Benefits to Issuers

We believe that issuers interested in raising capital through unregistered offerings could benefit from the proposed amendments. First, the proposed amendments would likely expand the pool of accredited investors compared to the current baseline. Expanding the availability of accredited investors could improve the likelihood of successfully raising capital in a Regulation D offering and enable a more efficient and potentially larger capital raising process. Accredited investors supply the vast majority of capital raised under Regulation D and are vital to the capital raising needs of issuers conducting unregistered offerings. By increasing the pool of accredited investors, issuers may be better able to fulfill their financing needs with possibly lower costs compared to preparing a registration statement and at a lower risk of disclosing proprietary information.

Similarly, the proposed amendments could enhance capital formation in the Regulation A market. As accredited investors are not subject to investment limits under Tier 2 of Regulation A, expanding the pool of accredited investors could enable issuers that are conducting offerings under Tier 2 of Regulation A to raise capital faster and at a relatively lower cost. In addition, the amendments to the accredited investor definition could increase capital raising under Rule 504 of Regulation D. Under Rule 504 of Regulation D, issuers are permitted to use general solicitation or general advertising to offer and sell securities when (i) offers and sales are made pursuant to state law exemptions from registration that permit general solicitation and general advertising and

(ii) sales are made only to accredited investors as defined in Rule 501(a). An increase in the number of accredited investors as a result of the rule could increase reliance on Rule 504.

Expanding the definition of qualified institutional buyer under Rule 144A would increase the number of potential buyers of Rule 144A securities, thus facilitating capital formation in this market by issuers conducting Rule 144A offerings.

In addition to the effects on the ability to raise capital, we expect the proposed rule to have an effect on the liquidity of securities issued in unregistered offerings. The proposed amendments to the qualified institutional buyer definition could also facilitate resales of Rule 144A securities by holders of these securities by expanding the pool of potential purchasers in resale transactions. This could increase demand for Rule 144A securities and have an impact on the price and liquidity of these securities when offered and sold by the issuer in Rule 144A offerings and in subsequent resale transactions. We are unable to quantify, however, the impact of any such potential changes resulting from the proposed amendments to the qualified institutional buyer definition.

Additionally, an expanded accredited investor definition could impact resales under Rule 501 of Regulation Crowdfunding during the one-year resale restriction period, thus potentially affecting the liquidity discount for such securities. Securities purchased in a crowdfunding transaction generally cannot be resold for a period of one year, unless they are transferred to, among other things, an accredited investor.[280] An expanded pool

[280] *See* Rule 501 under Regulation Crowdfunding [17 CFR 227.501]. Such securities could also be transferred (i) to the issuer of the securities; (ii) as part of an offering registered with the Commission; (iii) to a member of the family of the purchaser or the equivalent, to a trust controlled by the purchaser, to a trust created for the benefit of a member of the family of the purchaser or the equivalent, or in connection with the death or divorce of the purchaser or other similar circumstance.

of accredited investors as a result of the proposed amendments could make it easier for holders of such securities to find a potential buyer, thus potentially leading to a lower liquidity discount. Moreover, investors that are seeking to resell restricted securities and that rely on the Rule 144 safe harbor for purposes of determining whether the sale is eligible for the Section 4(a)(1) exemption are required to meet certain conditions under Rule 144, that can include holding the restricted securities for six months or one year, depending on the circumstances. An expanded accredited investor pool could make it easier to conduct a private resale of restricted securities in a time period shorter than six months or one year. For example, an investor may seek to rely on the Section 4(a)(7) exemption for the resale, which requires a number of conditions to be met, including that the purchaser is an accredited investor. If the proposed rule changes make it easier to conduct private resales of restricted securities, this could possibly reduce the liquidity discount for restricted securities when sold under Rule 506 (or another exemption), making Rule 506 more attractive to issuers as well as investors. We are unable to quantify, however, any such potential change in the liquidity for unregistered securities as a result of the proposed amendments.

Another potential benefit to issuers interested in raising capital through Rule 506(c) offerings is that the proposed amendments would provide issuers with additional ways to verify an investor's status as an accredited investor. As discussed in Section II.A above, issuers conducting offerings under Rule 506(c) are required to take reasonable steps to verify the accredited investor status of all purchasers in the offering. Compliance with this verification requirement has been cited as a potential impediment to the use of Rule 506(c) to raise capital despite the ability to use general solicitation when

conducting these types of offerings.[281] To the extent that issuers may face challenges complying with this requirement, the proposed amendments would provide issuers with additional avenues (*e.g.*, professional certifications and investment tests) to meet this requirement under certain circumstances, which could facilitate the use of Rule 506(c) as a capital raising option.

The proposed amendments also would increase the number of potential investors with whom issuers undertaking a registered offering may be able to communicate under Section 5(d) of the Securities Act and Securities Act Rule 163B (the test-the-waters provisions). By increasing the pool of potential institutional accredited investors and qualified institutional buyers, the proposed amendments would allow certain issuers to gather valuable information about investor interest before a potential registered offering.

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[281] *See, e.g.*, Peter Rasmussen, *Rule 506(c)'s General Solicitation Remains Generally Disappointing*, BLOOMBERG (May 26, 2017), https://www.bna.com/rule-506cs-general-b73014451604/. *See also*, comments of Jean Peters, Board Member, Angel Capital Association, at the 33rd Annual SEC Government-Business Forum on Small Business Capital Formation, Nov. 20, 2014, *available at* https://www.sec.gov/info/smallbus/sbforum112014-final-transcript.pdf; Manning G. Warren, *The Regulatory Vortex for Private Placements* (Univ. of Louisville Sch. of Law, Legal Studies Research Paper Series No. 2017-9, 2017) (summarizing discussions with securities counsel and the results of a survey of counsel specializing in private placements of securities regarding the reasons for reluctance to rely on Rule 506(c), including, among other factors, a reluctance to "engage in an independent verification process in order to objectively determine the accredited investor status of each accredited investor in Rule 506(c) offerings." With respect to the last concern, this study states that "[m]ost securities lawyers have not yet developed a comfort level with the necessary 'reasonable steps to verify.'… Moreover, this compliance requirement could chill the interests of many significant investors who have understandable reluctance to share their tax returns, brokerage statements and other confidential financial information with issuers' management and attorneys… [S]ome two-thirds of the respondents expressed concerns over compliance with the verification requirement… The possibilities that accredited investors will walk away from Rule 506(c) offerings based on privacy concerns clearly contributes to issuer reluctance to use Rule 506(c) and to a corollary preference to use Rule 506(b) as the exemption from registration."). *See also* Larissa Lee, *The Ban Has Lifted: Now Is the Time to Change the Accredited-Investor Standard*, 2014 UTAH L. REV. 369 (2014); Elan W. Silver, *Reaching the Right Investors: Comparing Investor Solicitation in the Private-Placement Regimes of the United States and the European Union*, 89 TUL. L. REV. 719 (2015); Dale A. Oesterle, *Intermediaries in Internet Offerings: The Future is Here*, 50 WAKE FOREST L. REV. 533 (2015).

This could result in a more efficient and potentially lower-cost and lower-risk capital raising process for such issuers.

Under Section 12(g) of the Exchange Act,[282] an issuer that is not a bank, bank holding company, or savings and loan holding company is required to register a class of equity securities under the Exchange Act if, on the last day of its fiscal year, it has more than $10 million in total assets and the securities are "held of record" by either 2,000 or more persons, or 500 or more persons who are not accredited investors.[283] To the extent that the proposed amendments increase the pool of accredited investors, issuers may be able to raise the capital that they need by selling securities to fewer non-accredited investors, which could enable these issuers to avoid becoming an Exchange Act reporting company for a longer period. To the extent that certain issuers remain non-reporting companies to limit compliance costs and the risk of disclosure of sensitive information to potential competitors, the proposed amendments may benefit such issuers by enabling them to stay non-reporting for a longer period.

A proposed amendment to the accredited investor definition would allow knowledgeable employees of private funds to qualify as accredited investors for purposes of investing in offerings by these funds without the funds themselves losing accredited investor status when the funds have assets of $5 million or less.[284] This proposed

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[282] 15 U.S.C. 78l(g).

[283] *Id.* *See also* 17 CFR 240.12g-1 (clarifying that accredited investor status for this purpose is determined as of the last day of its most recent fiscal year rather than at the time of the sale of the securities); and Changes to Exchange Act Registration Requirements Release at Section II.B. ("Under amended Rule 12g-1, an issuer will need to determine, based on facts and circumstances, whether prior information provides a basis for a reasonable belief that the security holder continues to be an accredited investor as of the last day of the fiscal year.").

[284] Under Rule 501(a)(8), a private fund with assets of $5 million or less may qualify as an accredited investor if all of the fund's equity owners are accredited investors.

amendment would potentially allow these private funds the ability to offer knowledgeable employees performance incentives, such as investing in the fund. Permitting employees who participate in the investment activities of a private fund to hold equity in such private funds may align incentives between such employees and investors. Although we expect that the increase in the capital that is supplied to private funds by knowledgeable employees of these private funds would likely be relatively small, the potential gains to the funds in incentive alignment and employee retention could affect fund performance positively.

2. Potential Benefits to Investors

There is recent empirical evidence that, for a number of reasons, issuers tend to stay private for longer and have been able to grow to a size historically available only to their public peers.[285] This suggests that the high-growth stage of the lifecycle of many issuers occurs while they remain private. Thus, investors that do not qualify for accredited investor status may not be able to participate in the high-growth stage of these issuers because it often occurs before they engage in registered offerings.[286] Allowing more investors to invest in unregistered offerings of private firms thus may allow them to participate in the high-growth stages of these firms.

We believe that newly eligible accredited investors could benefit from the proposed amendments as they would gain broader access to investment opportunities in

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[285] *See* Michael Ewens & Joan Farre-Mensa, *The Deregulation of the Private Equity Markets and the Decline in IPOs* (Nat'l Bureau of Econ. Research, Working Paper No. 26317, Sept. 2019) ("Ewens & Farre-Mensa (2019)").

[286] For example, according to Ritter (2019), the median age of a firm that went public in 1999 was 5, and in 2018 the median age was 10, https://site.warrington.ufl.edu/ritter/files/2019/03/IPOs2018Age.pdf. *See* Chairman Clayton, Remarks to the New York Economic Club (Sept. 9, 2019), *available at* https://www.sec.gov/news/speech/speech-clayton-2019-09-09.

private capital markets and greater freedom to make investment decisions based on their own analysis. Generally, expanding the set of investment opportunities can improve the risk-return tradeoff of an investor's portfolio.[287] While private investments may also offer the opportunity to invest in certain early-stage or high-growth firms that are not as readily available in the registered market, private investments, particularly in small and startup companies, generally pose a high level of risk. For example, based on Bureau of Labor Statistics (BLS) data on establishment survival rates, the five-year survival rates for private sector establishments formed in March 2013 was approximately 51%.[288] The higher risks of private investments may be mitigated by investing in professionally managed private funds rather than selecting private company investments directly.[289] Moreover, adding private investments to the set of investable assets could allow an investor to expand the efficient risk-return frontier and construct an optimal portfolio with risk-return properties that are better than, or similar to, the risk-return properties of a portfolio that is constrained from investing in certain asset classes. For example, recent research has shown that investments in funds of private equity funds can outperform public markets.[290]

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[287] *See, e.g.*, John L. Maginn et al., MANAGING INVESTMENT PORTFOLIOS: A DYNAMIC PROCESS (3rd ed. 2007) ("Maginn et al. (2007)"); Zvi Bodie, Alex Kane, & Alan J. Marcus, INVESTMENTS (10th ed. 2013).

[288] *See* BLS business employment dynamics establishment age and survival data, available at https://www.bls.gov/bdm/bdmage.htm and https://www.bls.gov/bdm/us_age_naics_00_table7.txt.

[289] *See, e.g.*, the recommendation to expand retail investor access to closed-end registered investment funds with significant exposures to alternatives (https://www.capmktsreg.org/wp-content/uploads/2018/10/Private-Equity-Report-FINAL-1.pdf).

[290] *See, e.g.*, Robert S. Harris et al., *Financial Intermediation in Private Equity: How Well Do Funds of Funds Perform?*, 129 J. FIN. ECON. 287 (2018);

However, comprehensive, market-wide data on the returns of private investments is not available due to a lack of required disclosure on these investment returns, the voluntary nature of disclosure of performance information by private funds, and the very limited nature of secondary market trading in these securities. Academic studies of the returns to private investments acknowledge limitations and biases in the available data.[291] For instance, it has been shown that the data on returns of private investments typically exhibits a survival bias due to the lack of reporting of underperforming investments and that the use of appraised valuations to construct returns on assets that are nontraded can

[291] Research has examined (i) private equity returns (*see, e.g.*, Steven N. Kaplan & Antoinette Schoar, *Private Equity Performance: Returns, Persistence, and Capital Flows*, 60 J. FIN. 1791 (2005); Andrew Metrick & Ayako Yasuda, *Venture Capital and Other Private Equity: A Survey*, 17 EUR. FIN. MGMT. 619 (2011); Christian Diller & Christoph Kaserer, *What Drives Private Equity Returns? Fund Inflows, Skilled GPs, and/or Risk?*, 15 EUR. FIN. MGMT. 643 (2009); Robert S. Harris et al., *Financial Intermediation in Private Equity: How Well Do Funds of Funds Perform?*, 129 J. FIN. ECON. 287 (2018); Robert S. Harris, Tim Jenkinson, & Steven N. Kaplan, *Private Equity Performance: What Do We Know?*, 69 J. FIN. 1851 (2014); Kasper Nielsen, *The Return to Direct Investment in Private Firms: New Evidence on the Private Equity Premium Puzzle*, 17 EUR. FIN. MGMT. 436 (2011)); (ii) VC performance (*see, e.g.*, John H. Cochrane, *The Risk and Return of Venture Capital*, 75 J. FIN. ECON. 3 (2005); Arthur Korteweg & Stefan Nagel, *Risk-Adjusting the Returns to Venture Capital*, 71 J. FIN. 1437 (2016); Axel Buchner, Abdulkadir Mohamed, & Armin Schwienbacher, *Does Risk Explain Persistence in Private Equity Performance?*, 39 J. CORP. FIN. 18 (2016)); and (iii) hedge fund returns (*see, e.g.*, William Fung & David A. Hsieh, *Hedge Fund Benchmarks: A Risk-Based Approach*, FIN. ANALYSTS J., Sept./Oct. 2004, at 65; William Fung & David A. Hsieh, *Measurement Biases in Hedge Fund Performance Data: An Update*, FIN. ANALYSTS J., May/June 2009, at 36; Manuel Ammann, Otto R. Huber, & Markus Schmid, *Benchmarking Hedge Funds: The Choice of the Factor Model* (Working Paper, 2011); Zheng Sun, Ashley W. Wang, & Lu Zheng, *Only Winners in Tough Times Repeat: Hedge Fund Performance Persistence over Different Market Conditions*, 53 J. FIN. & QUANTITATIVE ANALYSIS 2199 (2018); Charles Cao et al., *What Is the Nature of Hedge Fund Manager Skills? Evidence from the Risk-Arbitrage Strategy*, 51 J. FIN. & QUANTITATIVE ANALYSIS 929 (2016); Vikas Agarwal, T. Clifton Green, & Honglin Ren, *Alpha or Beta in the Eye of the Beholder: What Drives Hedge Fund Flows?*, 127 J. FIN. ECON. 417 (2018); Turan G. Bali, Stephen J. Brown, & Mustafa O. Caglayan, *Systematic Risk and the Cross Section of Hedge Fund Returns*, 106 J. FIN. ECON. 114 (2012); Turan G. Bali, Stephen J. Brown, & Mustafa O. Caglayan, *Macroeconomic Risk and Hedge Fund Returns*, 114 J. FIN. ECON. 1 (2014); Andrea Buraschi, Robert Kosowski, & Fabio Trojani, *When There Is No Place to Hide: Correlation Risk and the Cross-Section of Hedge Fund Returns*, 27 REV. FIN. STUD. 581 (2014); Ravi Jagannathan, Alexey Malakhov, & Dmitry Novikov, *Do Hot Hands Exist Among Hedge Fund Managers? An Empirical Evaluation*, 65 J. FIN. 217 (2010); Andrea Buraschi, Robert Kosowski, & Worrawat Sritrakul, *Incentives and Endogenous Risk Taking: A Structural View on Hedge Fund Alphas*, 69 J. FIN. 2819 (2014); Ronnie Sadka, *Liquidity Risk and the Cross-Section of Hedge-Fund Returns*, 98 J. Fin. Econ. 54 (2010); Ilia D. Dichev & Gwen Yu, *Higher Risk, Lower Returns: What Hedge Fund Investors Really Earn*, 100 J. FIN. ECON. 248 (2011)).

make private investments seem less risky. There is also a lack of comprehensive data on angel investment returns[292] and entrepreneur returns on investment of their own funds and savings in starting a private business.[293]

Other aspects of the proposed amendments could provide additional benefits for investors. For example, persons that are "knowledgeable employees" of a private fund may benefit from increased access to investment opportunities with the fund as well as the availability of additional performance incentives. If investments by knowledgeable employees leads to better incentive alignment between the fund and investment personnel, other investors in the private fund could potentially benefit from enhanced fund performance. Additionally, family clients that are part of a family office would be able to invest in unregistered offerings as a result of the proposed amendments without the loss of investor protection benefits. Similarly, the proposed amendments to allow natural persons to include spousal equivalents when determining joint income or net

[292] Studies we have identified have used small, selected samples—sometimes from foreign markets—that do not generalize to the entire U.S. market. *See, e.g.*, Vincenzo Capizzi, *The Returns of Business Angel Investments and Their Major Determinants*, 17 VENTURE CAP. 271 (2015) (using a small sample of Italian data); Colin M. Mason & Richard T. Harrison, *Is It Worth It? The Rates of Return from Informal Venture Capital Investments*, 17 J. BUS. VENTURING 211 (2002) (using a small UK sample). Investments through AngelList and similar platforms allow accredited investors to make VC-like investments in startups. The returns generated by such investments have been a topic of debate in the literature (*see, e.g.*, Olga Itenberg & Erin E. Smith, *Syndicated Equity Crowdfunding: The Trade-Off Between Deal Access and Conflicts of Interest* (Simon Bus. Sch., Working Paper No. FR 17-06, Mar. 2017)).

[293] *See, e.g.*, Elisabeth Mueller, *Returns to Private Equity – Idiosyncratic Risk Does Matter!*, 15 REV. FIN. 545 (2011) ("Mueller (2011)"); Thomas Astebro, *The Returns to Entrepreneurship*, in OXFORD HANDBOOK OF ENTREPRENEURIAL FINANCE (Douglas Cumming ed. 2012) ("Astebro (2012)"); Thomas J. Moskowitz & Annette Vissing-Jørgensen, *The Returns to Entrepreneurial Investment: A Private Equity Premium Puzzle?*, 92 AM. ECON. REV. 745 (2002) ("Moskowitz & Vissing-Jørgensen (2002)"). For instance, Moskowitz and Vissing-Jørgensen (2002) examine the returns to investing in U.S. non-publicly traded equity and find that, although entrepreneurial investment is extremely concentrated, the returns to private equity are no higher than the returns to public equity. They attribute the willingness of households to invest substantial amounts in a single privately held firm with a seemingly far worse risk-return trade-off to large nonpecuniary benefits, a preference for skewness, or overestimated probability of survival.

worth under Rule 501 of Regulation D would remove unnecessary barriers to investment opportunities for such investors.

With respect to entities, including additional entity types within the definition of accredited investor would provide equal access to investment opportunities for entities with similar attributes of financial sophistication or the ability to fend for themselves, regardless of their organizational form. The proposed amendments thus could help level the playing field among institutional investors and avoid certain inefficiencies associated with specific corporate forms. Likewise, the proposed amendment to include a catch-all category of accredited investor for entities with investments in excess of $5 million would remove impediments to utilizing alternative legal forms and permit sophisticated investors to take advantage of novel forms of business organization that may develop in the future, without having to worry about losing their accredited investor status. Since most family offices are likely already considered accredited investors, we do not expect them to receive significant benefits as a result of the proposed amendments.

3. Potential Costs to Issuers

We also recognize that expanding the pool of accredited investors could increase the availability of capital to private firms, which could allow them to stay private longer, thus reducing the number of companies going public. For example, some academic studies suggest that the expanding role of private markets has contributed to the decline in the number of public companies.[294] Some studies have focused on the increased

[294] *See* Ewens & Farre-Mensa (2019), *supra* note 284 and Craig Doidge et al., *Eclipse of the Public Corporation or Eclipse of the Public Markets?*, J. APPLIED CORP. FIN., Winter 2018, at 8.

flexibility to deregister provided by recent U.S. regulatory reforms.[295] Yet other studies generally note the cyclical nature of offering activity more generally.[296] How large the impact of the proposed rule is on the private-public choice is uncertain since there are a number of factors (*e.g.*, liquidity, cost of capital, ownership structure, compliance costs, valuations) that an issuer would consider when determining to go public or stay private.

4. Potential Costs to Investors

Newly eligible accredited investors would have access to more investment options under the proposed amendments. Some of these investment options could entail greater risk of loss. Thus, newly eligible accredited investors could face greater overall investment risk under the proposed amendments. The proposal is designed to limit the costs to investors by ensuring that accredited investor status is only afforded to investors that are either financially sophisticated and therefore able to fend for themselves or are able to sustain the risk of loss. To the extent that the ways we are proposing to expand the pool of potential accredited investors would include investors that are not financially sophisticated, such investors in this expanded state would bear the costs we discuss below.

We anticipate that some natural person investors who do not meet the income and wealth thresholds under the current definition, but that would qualify as accredited investors under the proposed amendments, may not be able to sustain a loss of investment

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[295] *See* Nuno Fernandes, Ugur Lel, & Darius P. Miller, *Escape from New York: The market impact of loosening disclosure requirements,* 95 J. FIN. ECON. 2 (2010) (focusing on "Rule 12h-6, which has made it easier for foreign firms to deregister with the SEC and thereby terminate their U.S. disclosure obligations"); Craig Doidge et al., *Why Do Foreign Firms Leave U.S. Equity Markets?*, 65 J. FIN. 4, 1507-1553.

[296] *See, e.g.*, Michelle Lowry, *Why does IPO Volume fluctuate so much?*, 67 J. FIN. ECON. 1 (2003), 3-40; Alti (2005); and Chris Yung et al., *Cycles in the IPO Market,* 89 J. FIN. ECON. 1 (2008), 192-208.

in an unregistered offering. For example, an individual that has obtained a Series 7 license or is a knowledgeable employee of a private fund may possess experience in investing but may be less able to withstand investment losses than an accredited investor qualifying on the basis of personal wealth. However, we believe this risk would be mitigated by the fact that the proposed amendments are intended to better identify investors' financial sophistication, which includes an ability to assess and avoid a risk of loss that the investor cannot sustain.

Investing in securities that are acquired in exempt offerings could reduce investors' liquidity while increasing their transaction and agency costs. Investors may experience reductions in liquidity by investing in these securities, as secondary market liquidity in these offerings remains limited. This illiquidity is generally related to legal restrictions on the transferability of securities issued in many exempt offerings; a lack—or a very limited nature—of a trading market;[297] long-term horizon for exits for private issuers; and, in cases of private funds investing in private issuers, standard contractual terms designed to enable a long-term horizon for the portfolio.[298] Investing in securities of private companies for which less information is publicly available, also could increase the agency costs for accredited investors. Since the vast majority of capital that is raised in exempt offerings is not accompanied by disclosures that are comparable to public companies' disclosures, investors would potentially have less information about these private companies compared to similar public companies, and they may not be able to

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[297] *See, e.g.*, David F. Larcker, Brian Tayan, & Edward Watts, *Cashing It In: Private-Company Exchanges and Employee Stock Sales Prior to IPO*, Stanford Closer Look Series (Sept. 12, 2018). *See also* Concept Release.

[298] *See, e.g.*, PRIVATE EQUITY: FUND TYPES, RISKS AND RETURNS, AND REGULATION (Douglas Cumming ed., 2011).

effectively monitor the management of these companies. As a result, investors in securities of private companies may bear a heightened risk that management may take actions that reduce the value of their stakes in such companies without such actions being disclosed. However, we believe that the risk of accredited investors not being able to manage their liquidity or agency risk would be mitigated because these investors are presumed to be financially sophisticated.

While investing in securities acquired in exempt offerings may increase an investor's diversification (as discussed above), there are practical frictions that can make it difficult for an investor to diversify risk using these investments. For example, investment minimums demanded by certain issuers may decrease or eliminate the diversification benefits of incorporating private investments in an individual investor's portfolio. Moreover, the increased competition amongst investors under an expanded accredited investor definition could lower investors' expected returns for private assets. That is, as more capital is available in the non-registered markets, investors could receive lower returns due to the entry of newly-accredited investors with a lower required rate of return or reduced search frictions associated with finding accredited investors. Further, it has been shown that the data on returns of private investments typically exhibits smoothing due to the infrequent nature of observation of returns and/or the use of appraised valuations and other methods to construct returns on assets that are nontraded.[299] This can result in an investor significantly overestimating the diversification benefits of private investments and underestimating the risk of private

[299] *See, generally,* Gregory W. Brown, Oleg R. Gredil, & Steven N. Kaplan, *Do Private Equity Funds Manipulate Reported Returns?*, 132 J. FIN. ECON. 267 (2019); Arthur Korteweg, *Risk Adjustment in Private Equity Returns* (Working Paper, 2018).

investments.[300] Additionally, when compared to traded securities of public companies, private investments may be characterized by considerable downside and tail risk due to the frequently non-normally distributed returns.[301] We think that the likelihood that accredited investors misunderstand the risk profile and associated portfolio constraints of securities acquired in exempt offerings is relatively low, as these investors are presumed to be financially sophisticated.

The proposed amendments could increase agency costs and reduce efficient capital allocation if investors are solicited with less information. Further, the combined presence of small individual investors without control rights and insiders or large private investors with concentrated control rights is likely to lead to agency conflicts. Such agency conflicts, as well as potentially an inability to negotiate preferential terms (such as downside protection options, liquidation preferences, and rights of first refusal) might place individual accredited investors, dollar-for-dollar, at a disadvantage to insiders and large investors. The impact of agency conflicts on minority investors in private companies might be relatively more significant than at exchange-listed companies because private companies generally are not subject to the governance requirements of exchanges or various proxy statement disclosures. However, as accredited investors are

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[300] *See, generally*, Maginn et al. (2007), *supra* note 286. *See also* Kenneth Emery, *Private Equity Risk and Reward: Assessing the Stale Pricing Problem*, J. PRIVATE EQUITY, Spring 2003, at 43; Arthur Korteweg & Morten Sorensen, *Risk and Return Characteristics of Venture Capital-Backed Entrepreneurial Companies*, 23 REV. FIN. STUD. 3738 (2010); Gregory W. Brown, Oleg R. Gredil, & Steven N. Kaplan, *Do Private Equity Funds Manipulate Reported Returns?*, 132 J. FIN. ECON. 267 (2019); Arthur Korteweg, *Risk Adjustment in Private Equity Returns* (Working Paper, 2018).

[301] *See, e.g.*, Mueller (2011), *supra* note 292; Astebro (2012), *supra* note 292; Moskowitz & Vissing-Jørgensen (2002), *supra* note 292. For instance, Moskowitz and Vissing-Jørgensen (2002) examine the returns to investing in U.S. non-publicly traded equity and find that, although entrepreneurial investment is extremely concentrated, the returns to private equity are no higher than the returns to public equity. They attribute the willingness of households to invest substantial amounts in a single privately held firm with a seemingly far worse risk-return trade-off to large nonpecuniary benefits, a preference for skewness, or overestimated probability of survival.

presumed to be financially sophisticated, we anticipate that they will have the experience, resources, and incentives to screen private offerings from both non-reporting and reporting issuers.

5. Variation in Economic Effects

The magnitude of the benefits and costs discussed above are expected to vary depending on the particular attributes of the affected issuers and investors.

With respect to issuers, we expect the proposed changes to be most valuable for firms that have greater uncertainty about the interest in their prospective offerings, particularly ones that are small, in development stages, or in geographic areas that currently have lower concentrations of accredited investors. Household income and net worth tend to be higher in the Northeast and West regions. Thus, issuers that are not in those regions may find it more difficult to solicit qualified accredited investors. For example, based on DERA staff analysis of Form 1-A filings from June 2015 to December 2018, approximately 24% of Regulation A issuers were located in California, 10% in Florida, and 8% in New York. Additionally, small businesses typically do not have access to registered capital markets and commonly rely on personal savings, business profits, home equity loans, and friends and family as initial sources of capital.[302] Small issuers that face more challenges in raising external financing may benefit more from increased access to accredited investors.[303] In particular, businesses owned by underrepresented minorities may benefit from increased access to accredited investors. For example, based on the 2014 Annual Survey of Entrepreneurs, 28.4% of Black

[302] *See* 2017 Treasury Report.

[303] *See* Lindsey & Stein (2019), *supra* note 262.

entrepreneurs and 17.5% of Hispanic entrepreneurs cited limited access to financial capital as having a negative impact on their firms' profitability.[304] Additionally, despite being more likely to seek new sources of funding, businesses owned by underrepresented minorities were more likely to demonstrate unmet credit needs relative to other groups,[305] which suggests that these businesses may benefit from amendments intended to facilitate private market capital raising.

We expect that issuers that predominately offer and sell securities in registered offerings or that market their offerings to non-accredited investors would be less likely to be affected by the proposed amendments. We expect the incremental benefits of the proposed amendments to be smaller for large and well-established issuers with low information asymmetry and a history of public disclosures, as these issuers likely have ready access to accredited investors, especially institutional accredited investors. Similarly, issuers with low costs of proprietary disclosure (*e.g.*, low research and development intensity and limited reliance on proprietary technology) may be less likely to benefit from the proposed amendments as they may be less reliant on exempt offerings.

With respect to investors, we expect the benefits and costs of the proposed amendments to be most immediately realized by new entrants to the pool of accredited investors, particularly entities that are not included in the current accredited investor definition and individuals that have professional certifications that do not meet the

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[304] Alicia Robb, "Financing Patterns and Credit Market Experiences: A Comparison by Race and Ethnicity for U.S. Employer Firms," a study for the Office of Advocacy, U.S. Small Bus. Admin. (Feb. 2018), *available at* https://www.sba.gov/sites/default/files/Financing_Patterns_and_Credit_Market_Experiences_report.pdf.

[305] *Id*.

current income and net worth thresholds. We also expect that providing additional measures of financial sophistication, other than personal wealth, could expand investment opportunities for individual investors in geographic regions with a lower cost of living.

6. Competition, Efficiency, and Capital Formation

The Commission believes that the proposed amendments are likely to facilitate capital formation by increasing issuers' access to accredited investors and increasing investors' access to capital markets. The impacts of the proposed amendments on competition, efficiency, and capital formation are discussed throughout this section and elsewhere in this release. The following discussion highlights several such impacts.

Most of the proposed amendments would expand the pool of accredited investors beyond the current baseline.

The increased pool of accredited investors could result in increased amounts of capital available to private issuers, thus increasing capital formation. Expanding the pool of accredited investors could also make the capital raising process more efficient by allowing potentially newer and informed investors to enter the market for private offerings. If the newly accredited investors bring new and uncorrelated information signals to the market (*e.g.*, because of their specialized knowledge and skills), such an increase in the number of investors could improve the price discovery process and make the market for private offerings more efficient. The increased pool of accredited investors could also enhance competition among investors in the market for private offerings, thus reducing the cost of capital for potential issuers and improving allocative efficiency.

The expansion of the accredited investor pool could also reduce the capital allocated to public markets if public markets attract relatively fewer offerings. Further, to the extent that an efficient market incorporates firm-specific information quickly and correctly, such an expansion could reduce the efficiency of public markets if there are fewer companies making disclosures into public markets. As discussed previously, various academic studies have attributed the expanding role of private markets as a contributing factor to the decline in the number of public U.S. companies over the past two decades.[306] Alternatively, another strand of academic literature pinpoints changes in the economies of scope and business structure that have decreased the feasibility and attractiveness of operating as a standalone small or medium-sized company as driving factors in the decline in the number of public companies and new listings.[307] As an important caveat, while some of the cited evidence allows side-by-side comparisons of aggregate trends in listings, IPOs, private placements, and mergers, it does not

[306] *See*, *e.g.*, Ewens & Farre-Mensa (2019), *supra* note 284; Craig Doidge et al., *Eclipse of the Public Corporation or Eclipse of the Public Markets?*, J. APPLIED CORP. FIN., Winter 2018, at 8.

[307] According to this literature, small and medium-sized companies increasingly follow the path of being acquired by larger competitors in lieu of going and remaining public, which accounts for the decline in IPOs and new listings, particularly of small and medium-sized companies. Being bought by a larger firm offers potential advantages to a smaller company, including speeding a product to market and helping smaller businesses realize "economies of scope." *See, e.g.*, Xiaohui Gao, Jay R. Ritter, & Zhongyan Zhu, *Where Have All the IPOs Gone?*, 48 J. FIN. & QUANTITATIVE ANALYSIS 1663 (2013); Jay R. Ritter, *Equilibrium in the Initial Public Offerings Market*, 3 ANN. REV. FIN. ECON. 347 (2011) (stating that although regulatory burdens account for some of the decline, much of the decline is due to a structural shift that has lessened the profitability of small independent companies relative to their value as part of a larger, more established organization that can realize economies of scope); Jay R. Ritter, *Re-Energizing the IPO Market* (Working Paper, 2012) (similarly focused on the economies of scope hypothesis); Paul Rose & Steven Davidoff Solomon, *Where Have All the IPOs Gone? The Hard Life of the Small IPO*, 6 HARV. BUS. L. REV. 83 (2016) (examining 3,081 IPOs from 1996-2012 and concluding that the decline in small IPOs appears more attributable to the "historical unsuitability of small firms for the public markets"); Andrea Signori & Silvio Vismara, *M&A Synergies and Trends in IPOs* (Working Paper, 2016); Jay R. Ritter, Andrea Signori, & Silvio Vismara, *Economies of Scope and IPO Activity in Europe*, in HANDBOOK OF RESEARCH ON IPOS (Mario Lewis & Silvio Vismara eds., 2013), at 11 (attributing the decline in European IPOs to market conditions and to economies of scope).

necessarily establish conclusive causal relations between the expansion of private markets and the contraction in the number of public U.S. companies.

To the extent that the proposed amendments better identify an investor's financial sophistication (*e.g.*, professional certifications for natural persons and an investments-owned threshold for entities), the expanded definition may increase market efficiency by allowing more informed investors into a larger segment of the capital market. The expanded pool of accredited investors could also increase the capital that is supplied to private markets, thereby potentially lowering investors' expected returns from investing in this market.

Additionally, as discussed above, expanding the accredited investor definition to include knowledgeable employees of a private fund could lead to better alignment between private funds and investors. The improved alignment could enable private funds to perform investing services more efficiently and effectively, thus potentially improving investor protection and market efficiency over the long term.

7. Alternatives

In this section, we evaluate reasonable alternatives to the proposed amendments. First, the Commission could leave the current income and net worth thresholds in place as proposed, but impose certain investment limitations. Inflation has expanded significantly the number of individuals who qualify as accredited investors based on income and net worth. Limiting investment amounts for individuals who qualify as accredited investors based solely on the current income or net worth thresholds could provide protections for those individuals who are less able to bear financial losses. For example, the Commission could consider limiting investments for individuals who

qualify as accredited investors solely based on the current thresholds to a percentage of their income or net worth (*e.g.*, 10% of prior year income or 10% of net worth, as applicable, per issuer, in any 12-month period). This alternative, however, would result in a smaller pool of accredited investors, reduce capital formation, and likely increase the implementation costs associated with verifying an investor's status as an accredited investor and her eligibility to participate in an offering.

The Commission also could consider increasing the individual income thresholds from $200,000 to $538,000 and the net worth threshold from $1 million to $2.7 million to reflect the impact of inflation since 1982. Such an alternative could provide further assurance that individuals eligible for accredited investor status are those investors who do not need protections rendered by registration under the Securities Act. Using the SCF, we estimate that an immediate catch-up inflation adjustment would shrink the accredited investor pool to 5.3 million households (representing 4.2% of the population of U.S. households) from the current pool of approximately 16 million households (representing 13% of the population of U.S. households). Thus, increasing the individual income and net worth thresholds would greatly reduce the number of natural persons who would qualify as accredited investors. Moreover, an immediate catch-up inflation adjustment would likely reduce the number of accredited investors in geographic areas with lower cost of living. As such, the adjusted income and wealth thresholds also could potentially increase the costs that issuers face by reducing issuers' access to capital and reducing investors' access to private investment opportunities. As discussed above in Section VII.B, accredited investors supplied 94% of the $1.5 trillion raised in Rule 506(b) offerings in 2018. Significantly reducing the pool of accredited investors through an

immediate catch-up inflation adjustment could thus have disruptive effects on capital raising activity in the Regulation D market.

The Commission also could consider indexing the financial thresholds in the definition for inflation on a going-forward basis, rounded to the nearest $10,000 every four years following the effective date of the final rule amendment. This alternative likely would reduce the change in the number of accredited investors relative to the baseline of leaving the thresholds fixed, holding all else constant. Using the 2016 SCF, we estimate that in 2019, had the current wealth and income thresholds been adjusted for inflation since 2015 and 2010, the proportion of U.S. households that would qualify as accredited investors would have been 11.4% and 10.4%, respectively, which is consistent with an inflation adjustment reducing the pool of accredited investors relative to the baseline.

If the Commission modifies the accredited investor definition as described above, the Commission also could consider grandfathering issuers' current investors who meet and continue to meet the current accredited investor standards with respect to future offerings of the securities of issuers in which the investors are invested at the time of the change. Grandfathering would provide protection from investment dilution for any person who no longer would be an accredited investor because of any changes to the definition. The grandfathering provision could apply to future investments in the same issuer only, and not to future investments in affiliates of the issuer. Grandfathering current investors would help to mitigate—although it likely would not completely eliminate—the potential disruptive effect to the Regulation D market of an immediate catch-up inflation adjustment.

As an alternative to the proposed amendments, the Commission could permit individuals with a minimum amount of investments to qualify as accredited investors. Investments may in some cases be a more meaningful measure of individuals' experience with and exposure to the financial and investing markets than income or net worth. An "investments" definition based on the definition of investments in Rule 2a51-1(b) would promote consistency across securities laws and provide a predictable framework. In 2007, the Commission proposed applying a $750,000 minimum investments-owned threshold.[308] Using the SCF to measure households' financial and nonfinancial wealth (excluding the value of a primary residence), we estimate that an investment-owned test of $750,000 would increase the number of households that would currently qualify as accredited investors from approximately 16 million households (representing 13% of the population of U.S. households) to 18.2 million households (representing 14.5% of the population of U.S. households). Thus, this alternative likely would increase the pool of accredited investors relative to the baseline. On the other hand, an unconditional investments-owned test that does not take into account a natural person's indebtedness or income could reduce investor protections relative to the baseline if individuals use leverage to fund their investments.

As another alternative to the proposed amendments, the Commission could permit individuals with experience investing in exempt offerings to qualify as accredited investors. For example, the Commission could consider adding a new category to the accredited investor definition that includes individuals who have invested in at least ten private securities offerings, each conducted by a different issuer, under Securities Act

[308] *See* 2007 Proposing Release.

Section 4(a)(2), Rule 506(b), or Rule 506(c). Expanding the accredited investor definition to include individuals with relevant investment experience would recognize an objective indication of financial sophistication. These individuals presumably have developed knowledge about the private capital markets, including their inherent risks. This experience may include performing due diligence, negotiating investment terms, and making valuation determinations. This alternative would increase the pool of accredited investors, although by less than the proposed amendments. At the same time, this alternative could significantly increase the implementation costs of determining an investor's status as an accredited investor, as verifying an individual's relevant investment experience likely would be cumbersome.

The Commission could also permit certain knowledgeable employees of a non-fund issuer to qualify as accredited investors in securities offerings of that issuer. For example, an employee that is an officer at a company should have access to the necessary information about that company to make an informed investment should the company decide to issue securities. Expanding the accredited investor definition to include certain knowledgeable employees of a non-fund issuer would increase the pool of accredited investors relative to the baseline, and could allow non-fund issuers to raise additional capital and potentially increase incentive alignments between employees and shareholders. On the other hand, this alternative could reduce investor protections, to the extent that a knowledgeable employee may be informed about a company's business operations, but not possess the relevant financial sophistication to assess the company's offerings.

Finally, the Commission could add even more specific entity types to the enumerated entity types in Rule 501(a), instead of the proposal to include all entities that meet an investments-owned test. For example, the Commission could expand the enumerated entity types in Rule 501(a) to include additional entity types such as Indian tribes and sovereign wealth funds. As detailed above in Section VII.D, adding specific entity types to the enumerated entity types in Rule 501(a) would expand the pool of accredited investors relative to the baseline. On the other hand, this alternative would result in a smaller number of new institutional accredited investors compared to the proposed amendments. Another alternative would be to apply an asset test for the new entities instead of an investments-owned test. An asset test would help to level the playing field among institutional investors and would reduce inefficiencies associated with specific corporate forms that could develop in the future relative to the current baseline. Moreover, an asset test would likely increase the number of new institutional investors that would qualify as accredited investors relative to an investments-owned test, as, all else equal, we expect more entities to have $5 million in assets than would have $5 million in investments. At the same time, to the extent that an investments-owned test is a better indicator of those investors who do not need the protections rendered by registration under the Securities Act than an asset test, this alternative could result in lower levels of market efficiency and investor protection compared to the proposed amendments.

Request for Comment

We request comment on all aspects of our economic analysis, including the potential benefits and costs of the proposed amendments and alternatives to the proposed

amendments, and whether the proposed amendments, if adopted, would promote efficiency, competition, and capital formation or have an impact on investor protection. Commenters are requested to provide empirical data, estimation methodologies, and other factual support for their views, in particular, on the estimates of costs and benefits for the affected parties.

70. Would expanding the accredited investor definition to encompass natural persons that are advised by investment professionals impact market efficiency, competition, capital formation, or investor protection? If so, what would those impacts be?

71. Does the current exempt offering framework provide certain issuers with sufficient access to accredited investors? For example, are there capital-raising needs specific to any of the following that are currently not being met due to limited access to accredited investors: issuers in particular industries, such as technology, biotechnology, or manufacturing; or issuers led by underrepresented minorities, women, or veterans? Is there quantitative data available that shows the extent to which accredited investors fulfill the capital raising needs of these issuers? Would amending the accredited investor definition in the manner we propose address any such financing gaps?

72. How should we evaluate whether our current exempt offering framework provides adequate investor protection for accredited investors? For example, is there quantitative data available that shows an increased incidence of fraud in particular types of exempt offerings or in the market for exempt offerings as a whole? If yes, is there any reliable way to predict whether the proposed amendments could

have any effect on the incidence of fraud in exempt offerings? What other factors should we consider in assessing fraud in exempt offerings?

VIII. PAPERWORK REDUCTION ACT

We do not believe that the proposed amendments would impose any new "collection of information" requirement as defined by the Paperwork Reduction Act of 1995,[309] nor create any new filing, reporting, recordkeeping, or disclosure requirements. As discussed in Sections II, III, V and VII above, by expanding the pool of accredited investors, the proposed amendments could facilitate exempt offerings conducted pursuant to Regulation D or Regulation A and/or enable some companies to defer becoming a public reporting company, which may impact the number of annual responses under associated collections of information.[310] It is difficult to estimate the magnitude of these effects as they would depend on a number of factors. Overall, however, we expect any impact on the annual number responses for associated collections of information to be incremental and relatively small, and therefore we are not proposing to adjust the burden estimates for these collections of information at this time. Accordingly, we are not submitting the proposed amendments to the Office of Management and Budget for review under the Paperwork Reduction Act.[311] We request comment on our assessment that the proposed amendments would not create any new, or revise any existing, collection of information pursuant to the Paperwork Reduction Act. We also request comment on whether the proposed amendments would impact the number of annual

[309] 44 U.S.C. 3501 et seq.

[310] These collections of information include: Form D (3235-0076), Form 1-A (3235-0286), Form 1-K (3235-0720), Form 1-SA (3235-0721), Form 1-U (3235-0722).

[311] 44 U.S.C. 3507(d) and 5 CFR 1320.11.

responses for any associated collections of information and, if so, how we should adjust our PRA burden estimates to reflect this impact.

IX. SMALL BUSINESS REGULATORY ENFORCEMENT FAIRNESS ACT

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA),[312] the Commission must advise OMB as to whether the proposed amendments constitute a "major" rule. Under SBREFA, a rule is considered "major" where, if adopted, it results or is likely to result in:

- An annual effect on the U.S. economy of $100 million or more (either in the form of an increase or a decrease);
- A major increase in costs or prices for consumers or individual industries; or
- Significant adverse effects on competition, investment, or innovation.

Request for Comment

We request comment on whether the proposed amendments would be a "major rule" for purposes of SBREFA. In particular, we request comment on the potential effect of the proposed amendments on the U.S. economy on an annual basis; any potential increase in costs or prices for consumers or individual industries; and any potential effect on competition, investment or innovation. Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

X. INITIAL REGULATORY FLEXIBILITY ANALYSIS

When an agency issues a rulemaking proposal, the Regulatory Flexibility Act ("RFA")[313] requires the agency to prepare and make available for public comment an

[312] 5 U.S.C. 801 *et seq*.

[313] 5 U.S.C. 601 *et seq*.

Initial Regulatory Flexibility Analysis ("IRFA") that will describe the impact of the proposed rule on small entities.[314] This IRFA relates to proposed amendments to Rules 215 and 501(a) of the Securities Act.[315]

A. Reasons for, and Objectives of, the Proposed Action

The primary objective of the proposed amendments is to update and improve the definitions of accredited investor and qualified institutional buyer. The reasons for, and objectives of, the proposed amendments are discussed in more detail in Sections II through IV above.

B. Legal Basis

We are proposing the amendments pursuant to Sections 2(a)(11), 2(a)(15), 4(a)(1), 4(a)(3)(A), 4(a)(3)(C), 19(a), and 28 of the Securities Act and Sections 3(a)(51)(B), 3(b), 15(c), 15(g), and 23(a) of the Exchange Act.

C. Small Entities Subject to the Proposed Rule

The proposed amendments would affect issuers that are small entities. The RFA defines "small entity" to mean "small business," "small organization," or "small governmental jurisdiction."[316] For purposes of the RFA, under 17 CFR 230.157, an issuer, other than an investment company, is a "small business" or "small organization" if it had total assets of $5 million or less on the last day of its most recent fiscal year and is engaged or proposing to engage in an offering of securities not exceeding $5 million.

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[314] 5 U.S.C. 603(a).

[315] Because the proposed changes to Rule 144A of the Securities Act relate to entities that in the aggregate own and invest on a discretionary basis at least $100 million in securities of issuers that are not affiliated with the entity, we do not believe the proposed changes to Rule 144A would have an impact on small entities.

[316] 5 U.S.C. 601(6).

Under 17 CFR 240.0-10(a), an investment company, including a business development company, is considered to be a small entity if it, together with other investment companies in the same group of related investment companies, has net assets of $50 million or less as of the end of its most recent fiscal year.

The proposed amendments would allow more investors to qualify as accredited investors, which would permit all issuers, including small entities, to offer and sell securities in the private markets to more investors. Because the proposed amendments would affect all issuers, both reporting and non-reporting, it is difficult to estimate the number of issuers that qualify as small issuers that would be eligible to rely on the proposed amendments.

D. Projected Reporting, Recordkeeping and Other Compliance Requirements

The proposed amendments do not impose any new reporting or recordkeeping requirement, although, as with any Regulation D offering, the issuer must file a Form D with the Commission when conducing an offering under the exemptions provided in Regulation D. Further, small entities are not required to offer and sell securities to accredited investors who would be newly qualified under the proposed rules. As a result, we do not expect the proposed amendments to significantly impact existing reporting, recordkeeping, and other compliance burdens. Small entities choosing to avail themselves of the proposed amendments may seek the advice of legal or accounting professionals in connection with offers and sales to accredited investors. We discuss the economic impact, including the estimated costs and benefits, of the proposed amendments to all issuers, including small entities, in Section VII above.

E. Duplicative, Overlapping, or Conflicting Federal Rules

We do not believe the proposed amendments would duplicate, overlap, or conflict with other federal rules, although, as discussed in Section V, the proposed amendments could have implications for a number of other contexts under the federal securities laws.

F. Significant Alternatives

The RFA directs us to consider alternatives that would accomplish our stated objectives, while minimizing any significant adverse impact on small entities. In connection with the proposed amendments, we considered the following alternatives:

- Establishing different compliance or reporting requirements that take into account the resources available to small entities;
- Clarifying, consolidating, or simplifying compliance and reporting requirements under the rules for small entities;
- Using performance rather than design standards; and
- Exempting small entities from all or part of the requirements.

The proposed amendments would not establish any new reporting, recordkeeping, or compliance requirements for small entities and, as noted above, small entities are not required to offer and sell securities to accredited investors who would be newly qualified under the proposed rules. Accordingly, we do not believe it is necessary to exempt small entities from all or part of the proposed amendments or to consider different or simplified compliance requirements for these entities. To the extent that issuers may face challenges complying with the requirement in Rule 506(c) of Regulation D to verify an accredited investor's status, the proposed amendments would provide issuers, including

small entities, with additional ways to meet this verification requirement that are objective and readily verifiable.

G. Request for Comment

We encourage the submission of comments with respect to any aspect of this Initial Regulatory Flexibility Analysis. In particular, we request comments regarding:

- The number of small entities that may be affected by the proposed amendments;
- The existence or nature of the potential impact of the proposed amendments on small entity issuers discussed in the analysis; and
- How to quantify the impact of the proposed amendments.

Commenters are asked to describe the nature of any impact and provide empirical data supporting the extent of the impact. Comments will be considered in the preparation of the Final Regulatory Flexibility Analysis, if the proposed amendments are adopted, and will be placed in the same public file as comments on the proposed amendments themselves.

XI. STATUTORY AUTHORITY AND TEXT OF PROPOSED RULE AMENDMENTS

The amendments contained in this release are being proposed under the authority set forth in Sections 2(a)(11), 2(a)(15), 4(a)(1), 4(a)(3)(A), 4(a)(3)(C), 19(a), and 28 of the Securities Act and in Sections 3(a)(51)(B), 3(b), 15(c), 15(g), and 23(a) of the Exchange Act.

List of Subjects in 17 CFR Parts 230 and 240

Reporting and recordkeeping requirements, Securities.

For the reasons set out above, the Commission proposes to amend Title 17, chapter II of the Code of Federal Regulations, as follows:

Part 230 – GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1933

1. The authority citation for part 230 continues to read as follows:

Authority: 15 U.S.C. 77b, 77b note, 77c, 77d, 77f, 77g, 77h, 77j, 77r, 77s, 77z-3, 77sss, 78c, 78d, 78j, 78*l*, 78m, 78n, 78o, 78o-7 note, 78t, 78w, 78*ll*(d), 78mm, 80a-8, 80a-24, 80a-28, 80a-29, 80a-30, and 80a-37, and Pub. L. 112-106, sec. 201(a), sec. 401, 126 Stat. 313 (2012), unless otherwise noted.

* * * * *

2. Amend § 230.144A by revising paragraph (a)(1)(i)(C); revising paragraph (a)(1)(i)(H); replacing the "." at the end of paragraph (a)(1)(i)(I) with "and ;"; and adding a new paragraph (a)(1)(i)(J). The revisions and addition read as follows:

§ 230.144A Private resales of securities to institutions.

(a) * * *

(1) * * *

(i) * * *

(C) Any *Small Business Investment Company* licensed by the U.S. Small Business Administration under section 301(c) or (d) of the Small Business Investment Act of 1958 or any *Rural Business Investment Company* as defined in section 384A of the Consolidated Farm and Rural Development Act;

* * * * *

(H) Any organization described in section 501(c)(3) of the Internal Revenue Code, corporation (other than a bank as defined in section 3(a)(2) of the Act or a savings and loan association or other institution referenced in section 3(a)(5)(A) of the Act or a

foreign bank or savings and loan association or equivalent institution), partnership, limited liability company, or Massachusetts or similar business trust;

* * * * *

(J) Any institutional accredited investor, as defined in rule 501(a) under the Act (17 CFR § 230.501(a)), of a type not listed in paragraphs (a)(1)(i)(A) through (I) or paragraphs (a)(1)(ii) through (vi).

* * * * *

3. Amend § 230.163B by revising paragraph (c)(2) to read as follows:

§ 230.163B Exemption from section 5(b)(1) and section 5(c) of the Act for certain communications to qualified institutional buyers or institutional accredited investors.

* * * * *

(2) Institutions that are accredited investors, as defined in §§230.501(a)(1), (a)(2), (a)(3), (a)(7), (a)(8), (a)(9), or (a)(12).

4. Amending § 230.215 to read as follows:

§ 230.215 Accredited investor.

The term *accredited investor* as used in section 2(a)(15)(ii) of the Securities Act of 1933 (15 U.S.C. 77b(a)(15)(ii)) shall have the same meaning as the definition of that term in rule 501(a) under the Act (17 CFR § 230.501(a)).

* * * * *

5. Amend § 230.501(a) by revising paragraph (a)(1); revising paragraph (a)(3); revising the first sentence of paragraph (a)(5); adding a Note in between paragraphs (a)(5) and (a)(6); revising paragraph (a)(6); deleting the “and” at the end of

paragraph (a)(7); replacing the "." at the end of paragraph (a)(8) with a ";"; adding a Note in between paragraphs (a)(8) and (a)(9); adding new paragraphs (a)(9) and (a) (10), with Notes; adding new paragraphs (a)(11), (12), and (13); and adding new paragraph (j). The revisions and additions read as follows:

§ 230.501 Definitions and terms used in Regulation D.

(a) * * *

(1) Any bank as defined in section 3(a)(2) of the Act, or any savings and loan association or other institution as defined in section 3(a)(5)(A) of the Act whether acting in its individual or fiduciary capacity; any broker or dealer registered pursuant to section 15 of the Securities Exchange Act of 1934; any investment adviser registered pursuant to section 203 of the Investment Advisers Act of 1940 or registered pursuant to the laws of a state; any insurance company as defined in section 2(a)(13) of the Act; any investment company registered under the Investment Company Act of 1940 or a business development company as defined in section 2(a)(48) of that act; any Small Business Investment Company licensed by the U.S. Small Business Administration under section 301(c) or (d) of the Small Business Investment Act of 1958; any Rural Business Investment Company as defined in section 384A of the Consolidated Farm and Rural Development Act; any plan established and maintained by a state, its political subdivisions, or any agency or instrumentality of a state or its political subdivisions, for the benefit of its employees, if such plan has total assets in excess of $5,000,000; any employee benefit plan within the meaning of the Employee Retirement Income Security Act of 1974 if the investment decision is made by a plan fiduciary, as defined in section 3(21) of such act, which is either a bank, savings and loan association, insurance

company, or registered investment adviser, or if the employee benefit plan has total assets in excess of $5,000,000 or, if a self-directed plan, with investment decisions made solely by persons that are accredited investors;

* * * * *

(3) Any organization described in section 501(c)(3) of the Internal Revenue Code, corporation, Massachusetts or similar business trust, partnership, or limited liability company, not formed for the specific purpose of acquiring the securities offered, with total assets in excess of $5,000,000;

* * * * *

(5) Any natural person whose individual net worth, or joint net worth with that person's spouse or spousal equivalent, exceeds $1,000,000;

* * * * *

NOTE: For the purposes of calculating joint net worth in paragraph (a)(5): joint net worth can be the aggregate net worth of the investor and spouse or spousal equivalent; assets need not be held jointly to be included in the calculation. Reliance on the joint net worth standard of (a)(5) does not require that the securities be purchased jointly.

(6) Any natural person who had an individual income in excess of $200,000 in each of the two most recent years or joint income with that person's spouse or spousal equivalent in excess of $300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year;

* * * * *

NOTE: It is permissible to look through various forms of equity ownership to natural persons in determining the accredited investor status of entities under paragraph (a)(8). If

those natural persons are themselves accredited investors, and if all other equity owners of the entity seeking accredited investor status are accredited investors, then paragraph (a)(8) may be available.

(9) Any entity, of a type not listed in paragraphs (a)(1), (a)(2), (a)(3), (a)(7), or (a)(8), not formed for the specific purpose of acquiring the securities offered, owning investments in excess of $5,000,000;

NOTE: For the purposes paragraph (a)(9), "investments" is defined in rule 2a51-1(b) under the Investment Company Act of 1940 (17 CFR § 270.2a51-1(b)).

(10) Any natural person holding in good standing one or more professional certifications or designations or credentials from an accredited educational institution that the Commission has designated as qualifying an individual for accredited investor status. In determining whether to designate a professional certification or designation or credential from an accredited educational institution for purposes of this paragraph (a)(10), the Commission will consider, among others, the following attributes:

(i) the certification, designation, or credential arises out of an examination or series of examinations administered by a self-regulatory organization or other industry body or is issued by an accredited educational institution;

(ii) the examination or series of examinations is designed to reliably and validly demonstrate an individual's comprehension and sophistication in the areas of securities and investing;

(iii) persons obtaining such certification, designation, or credential can reasonably be expected to have sufficient knowledge and experience in

financial and business matters to evaluate the merits and risks of a prospective investment; and

(iv) an indication that an individual holds the certification or designation is made publicly available by the relevant self-regulatory organization or other industry body;

NOTE: The professional certifications or designations or credentials currently recognized by the Commission as satisfying the above criteria will be posted on the Commission's website.

(11) Any natural person who is a "knowledgeable employee," as defined in rule 3c-5(a)(4) under the Investment Company Act of 1940 (17 CFR § 270.3c-5(a)(4)), of the issuer of the securities being offered or sold where the issuer would be an investment company, as defined in section 3 of such act, but for the exclusion provided by either section 3(c)(1) or section 3(c)(7) of such act;

(12) Any "family office," as defined in rule 202(a)(11)(G)-1 under the Investment Advisers Act of 1940 (17 CFR § 275.202(a)(11)(G)-1):

(i) with assets under management in excess of $5,000,000,

(ii) that is not formed for the specific purpose of acquiring the securities offered, and

(iii) whose prospective investment is directed by a person who has such knowledge and experience in financial and business matters that such family office is capable of evaluating the merits and risks of the prospective investment; and

(13) Any "family client," as defined in rule 202(a)(11)(G)-1 under the Investment Advisers Act of 1940 (17 CFR § 275.202(a)(11)(G)-1)), of a family office meeting the requirements in paragraph (a)(12) of this section.

* * * * *

(j) *Spousal equivalent*. The term *spousal equivalent* shall mean a cohabitant occupying a relationship generally equivalent to that of a spouse.

* * * * *

PART 240 – GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

1. The authority citation for part 240 continues to read in part as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78c-3, 78c-5, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78*l*, 78m, 78n, 78n-1, 78o, 78o-4, 78o-10, 78p, 78q, 78q-1, 78s, 78u-5, 78w, 78x, 78*ll*, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, 7201 et seq.; and 8302; 7 U.S.C. 2(c)(2)(E); 12 U.S.C. 5221(e)(3); 18 U.S.C. 1350; and Pub. L. 111-203, 939A, 124 Stat. 1887 (2010); and secs. 503 and 602, Pub. L. 112-106, 126 Stat. 326 (2012), unless otherwise noted.

* * * * *

2. Amend § 240.15g-1 by revising paragraphs (b) and (c) to read as follows:

§ 240.15g-1 Exemptions for certain transactions.

* * * * *

(b) Transactions in which the customer is an institutional accredited investor, as defined in 17 CFR 230.501(a)(1), (2), (3), (7), (8), (9), or (12).

(c) Transactions that meet the requirements of Regulation D (17 CFR 230.500 *et seq.*), or transactions with an issuer not involving any public offering pursuant to section 4(a)(2) of the Securities Act of 1933.

* * * * *

By the Commission.

Vanessa A. Countryman,
Secretary

Dated: December 18, 2019