March 14, 2016

---

http://engine.is

Dear SEC Staff:

Engine is a non-profit and advocacy group that supports high-growth, high-tech startups through research, advocacy, and policy analysis. We strive to foster forward-looking government policies and a regulatory environment in which innovative, new companies, with the potential to make an outsized impact on our economy, can launch, scale, and thrive throughout the United States. In working with entrepreneurs throughout the country to understand the challenges they face, we know capital access is chief among those challenges.

Accredited Investors and the Startup Ecosystem

We read the SEC's Report on the Review of the Definition of "Accredited Investor" with great interest. This definition is extremely important for the startup ecosystem, because the most common legal arrangement that startups use to raise funds, Regulation D, limits participation almost exclusively to accredited investors. Despite new forms of non-accredited investor funding, including Regulation A+ under the JOBS Act's Title IV and regulation crowdfunding under the JOBS Act's Title III, we believe most companies, especially in their early stages, will continue to rely on Regulation D. Reg A+ is better suited for more mature private companies seeking a large influx of capital. And despite our enthusiasm for investment crowdfunding, we have concerns about its potential to adequately address the capital challenges for startups given the final regulatory framework and its relatively high cost for issuers.

Data from the Angel Capital Association (ACA) shows why increasing the accredited investor thresholds would be so damaging to the startup economy.[1] The ACA estimates that some 25 percent of its over 12,000 members would lose accredited investor status and that this loss would be even more significant in areas outside of New York, Boston, and Silicon Valley, where venture capital is already much harder to come by. In 2015, nearly 70 percent of venture capital was limited to these three regions.[2] One third of ACA members in other regions would no longer

---

[1] Angel Capital Association, "Act Now: Protect Angel Startup Funding," (2014), http://www.angelcapitalassociation.org/aca-public-policy-protect-angel-funding.
[2] National Venture Capital Association, "National Aggregate Data," (2015), http://nvca.org/research/venture-investment.

qualify if the threshold were adjusted, unduly amplifying the barriers startups outside the coasts already face in securing adequate seed funding from existing VCs and angel networks.

Beyond spreading capital across geographies, angel investors are also opening doors for female and minority entrepreneurs. Venture capital is notoriously biased when it comes to financing women and non-white founders.[3] However, angel investing shows enormous promise in this area. Female and minority representation in the angel investor community far outpaces their representation amongst venture capitalists. Consequently, a much higher proportion of women and minorities are funded by the angel community compared to VC.[4]

An Unwarranted Increase

Considering the financial threshold hasn't changed since it was originally established in 1983, it's perfectly understandable to revisit the definition to make sure it's still accomplishing its original goals of protecting people without sufficient financial foundations to take on the economic risks of private investments. Yet, assessing what's transpired in the startup and investment world since 1983 doesn't suggest the definition needs changing—at least not in any way that would further limit who can invest. By maintaining the accredited investor qualifications for so long, the SEC has enabled more investors to participate in supporting the startup economy, facilitating a thriving angel investor community that continues to grow and diversify each year.[5] And this has all happened in an era in which the availability of information about business investments, and the opportunities to make those investments, have exponentially increased.

These are indeed different times to be an entrepreneur or an investor, which is why the SEC staff's recommendation to adjust the accredited investor definition for inflation is misguided. Though far more people can pursue these admittedly extremely risky investments than could in 1983, there is no evidence that the present definition has harmed individuals who would be excluded under an inflation-adjusted threshold. Any increase in the financial thresholds should be justified based on the goals of the definition, and there is no evidence that the current definition is failing to adequately protect investors. Consequently, increasing the threshold will

---

[3] From 2011-2013, companies with a female CEO received only 3 percent of the total venture capital dollars distributed. Candida Brush, Arthur M. Blank Center for Entrepreneurship Babson College, "Women Entrepreneurs 2014: Bridging the Gender Gap in Venture Capital," (2014), http://www.babson.edu/Academics/centers/blank-center/global-research/diana/Documents/diana-project- executive-summary-2014.pdf.

[4] Jeffrey Sohl, University of New Hampshire Center for Venture Research, "The Angel Investor Market in 2014: A Market Correction in Deal Size," (2014), https://paulcollege.unh.edu/sites/paulcollege.unh.edu/files/webform/2014%20Analysis%20Report.pdf.

[5] Karen E. Klein, Bloomberg Business, "Rise of Female Angel Investors Fuels Women-Run Companies," (2014), http://www.bloomberg.com/bw/articles/2014-09-10/angel-investing-rise-of-women-investors-fuels- women-run-companies.

merely serve to limit the pool of available capital without any clear resultant investor protection benefit.

Additional Qualitative Criteria

We were pleased to see the SEC staff recognize that income alone may not be the best way to determine suitability for investment in private companies. We support the report's recommendations that the agency consider creating new ways to qualify and we suggest SEC staff look to the U.K.'s approach to regulating retail investor activity in the investment crowdfunding market for guidance. Equity crowdfunding has boomed in the U.K., growing at an average rate of 410 percent from 2012 to 2014, driven largely by the Financial Conduct Authority's permissive approach to investor participation.[6] Though the U.K.'s "high net worth investor" threshold is far lower than even the current U.S. accredited investor threshold (investors with either approximately $150,000 in annual income or $350,000 in assets excluding their home qualify),[7] nearly 80 percent of investors participating in U.K. equity crowdfunding did not qualify as "high net worth investors."[8] Nevertheless, many of these investors were able to participate under one of the U.K.'s many alternate qualification pathways. For example, investors can qualify as "sophisticated investors," if they receive a certificate from an investment firm indicating that they have demonstrated sufficient knowledge to understand the risks of investing in certain financial assets.[9] Similarly, an investor can "self-certify" if they are part of a syndicate of investors, have made similar investments in the past, have worked in finance, or have served as the director of a company with more than £1 million in annual turnover.[10]

As a result of these alternative pathways, non-high net worth individuals invested more than £65 million in equity crowdfunding transactions in 2014 alone. Crucially, there has been no significant incidence of fraud or unwise investing by virtue of opening up startup investing to non-high net worth individuals.[11] The U.K.'s success in crafting non-means based standards for investor qualification reveals the need for similar protocols in the U.S.

Nonetheless, we hope any expansion of qualification criteria is not merely a concession for increasing the income thresholds. Determining and administering any new criteria will require complex, thoughtful, and likely slow-moving rulemaking that could unnecessarily limit capital

---

[6] Peter Baeck, et al., Nesta and the University of Cambridge, "Understanding Alternative Finance," (2014), https://www.nesta.org.uk/sites/default/files/understanding-alternative-finance-2014.pdf.
[7] Financial Conduct Authority Conduct of Business Sourcebook § 4.12.6.
[8] Nesta Report, *supra* note 6 at 19-20.
[9] Financial Conduct Authority Conduct of Business Sourcebook § 4.12.7.
[10] *Id.* § 4.12.8.
[11] In the equity crowdfunding context, the average retail investor's portfolio is less than £4,000. Nesta Report, *supra* note 6 at 53.

formation in the intervening period, an especially alarming prospect given current projections that VCs will be making fewer investments this year.

The SEC's Recommendations

We recognize that the authors of the report fully understand that the inflation-adjusted caps would "shrink the accredited investor pool considerably" and we appreciate their consideration of additional income-based conditions to mitigate this effect. These include allowing investors who currently qualify as accredited investors but fall short of the proposed inflation-adjusted thresholds to maintain some accredited investor rights with limitations on how much they can invest, and allowing non-qualifying households with existing minimum investments to obtain accredited investor status. SEC staff estimate this additional criteria would actually *expand* the pool of eligible accredited investors to include 11 percent of U.S. households. While this higher percentage is certainly appealing, it's not entirely convincing. The new limitations on existing accredited investors would effectively create a second tier of accredited investor, diminishing the total pool of capital available to startups. And households qualifying under the minimum investment threshold already have large portions of their net worth tied up in other investment assets, leaving limited remaining capital to participate in private offerings.

These proposals that the SEC estimates would expand the pool of accredited investors are puzzling. If the SEC is ultimately willing to grow the class of accredited investors, why modify the minimum income threshold in the first place? Instead of creating new, conditional income- and net worth- based criteria in order to qualify, expanding the pool of eligible investors would be better accomplished by adding qualitative measures for investor sophistication as discussed above.

In closing, we urge the SEC to continue exploring new eligibility requirements that enable a greater proportion and diversity of Americans to participate in financing startups, but without disrupting the current financial thresholds.

Sincerely,

Evan Engstrom, Executive Director
Anna Duning, Senior Manager, Policy Programs