National Small Business Association®

Brent J. Fields
Secretary
Securities & Exchange Commission
100 F Street NE
Washington, D.C. 20549-1090

Re: File No. 4-692: NSBA Comments on the SEC Report on the Review of the Definition of Accredited Investor

Dear Mr. Fields,

The National Small Business Association is pleased to provide these comments regarding the "Report on the Review of the Definition of Accredited Investor, " (the Report) published in December 2015 by the Securities and Exchange Commission (SEC).

The National Small Business Association (NSBA) was founded in 1937 to advocate for the interests of small businesses in the U.S. and it is the oldest small business organization in the country. The NSBA represents more than 65,000 small businesses throughout the country in virtually all industries and of widely varying sizes.

Offerings under Regulation D are incredibly important to the small business community, and represent an enormous amount of the capital raised by small businesses. As such, who qualifies as an accredited investor and may easily participate in those offerings, is of paramount importance to the community. While, inarguably carrying greater risk, investment in small businesses also carries the potential for enormous gains, and those potential gains should be available to everyone who can responsibly invest not just the very wealthy.

Some of the recommendations made in the Report are not ideal, but many of them would help small businesses by responsibly expanding the pool of investors who fall under the "accredited investor" definition. However, much thought needs to be put into the way all of these new qualifying criteria will fit together under a new definition, especially if it is bifurcated as proposed.

Generally, NSBA is in favor of changing the "accredited investor" definition to encompass more of those parties who possess the sophistication to responsibly invest in Regulation D offerings. In that vein, using objective tests, either a new one created for the purpose or existing tests, to determine the sophistication of investors would be a step forward, and would expand small business access to capital. Similarly, expanding the definition to encompass those with experience in these investments or who work closely with particular investments also expands the potential pool of investors and allows them to responsibly invest in the securities in question and by extension small businesses. These are positive changes and would increase investment opportunities with little, if any, impact on investor safety.

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However, NSBA is concerned with the some of the recommendations in the Report. We are particularly concerned with the effect of two separate recommendations which when taken together would bifurcate the "accredited investor" definition.[1] Through creating a tiered structure to the definition, the SEC could introduce new levels of complexity into verifying an accredited investor's status and would increase the cost of raising money for small businesses. Furthermore, we note that while the Report states that it expects the number of qualifying households in the U.S. to increase with the changes introduced, that is really only half the story. The amount of funds potentially available, is more important than the amount of parties who can invest. Under the tiered structure recommended, a significant portion of the accredited investors, would be limited in the size of their investments. This is a drastic change, and could ultimately limit the amount of funds available to small businesses, even as the overall number of accredited investors increases.

Additionally, there are several auxiliary methods of qualifying as an accredited investor contemplated in this report, including professional certifications, passing a standardized test or from investment experience among other things. NSBA is supportive of expanding the definition of encapsulate all manner of responsible ways to assess an investor's sophistication. However, in the event that the SEC adopts these alternative methods into the definition, it should make clear that investors qualifying under those alternative methods are not treated any differently than those qualifying by the more established criteria like the financial thresholds.

For clarity's sake, comments relating to specific recommendations made in the Report can be found under each recommendation, below. Following the comments relating to specific recommendations, are additional recommendations which NSBA would submit to SEC for its consideration.

Specific Responses to SEC Recommendations

1. The Commission Should Revise the Financial Threshold Requirements for Natural Persons to Qualify as Accredited Investors and the List-Based Approach for Entities to Qualify as Accredited Investors.

A. Leave the Current Income and Net Worth Thresholds in Place, Subject to Investment Limitations

At the outset, NSBA must express its concern with the tiered approach to accredited investors which this Report recommends. The effect of the recommendations made in Section IX.1.A and IX.1.B. would be to create a lower tier of accredited investors who are limited in their ability to invest and an upper tier with no such restrictions. The definition for an accredited investor, should be binary. A party should either qualify or not. Creating a middle-ground or a lower tier will only increase the regulatory burdens and make it more difficult for small businesses to comply with the regulations. Under the tiered system recommended, rather than simply determining whether or not someone qualifies as an accredited investors, a determination would also have to be made regarding whether that party has already reached the investment limit that the Report recommended implementing. This is difficult information for small business or even the broker to obtain, and needlessly complicates the process.

[1] The recommendations made in Section IX.1.A and Section IX.1.B would essentially create two classes of "accredited investors." While, it is not clear from the Report which, if any, of the recommendations that SEC is planning on adopting, it did assume the recommendations made in both those sections would be adopted when conducting its analysis (Table 10.5). Therefore, the following comments are made under the presumption that those recommendations would be implemented along with the tiered structure they would create when taken together.

Furthermore, this tiered system would further complicate matters when coupled with the proposed tests and other methods which expand the pool of accredited investors. Must an investor pass the test with a certain score to avoid being pegged in the lower tier? Similar questions surround passage of examinations like the Series 7. If the SEC is introducing several new methods of qualifying as an accredited and at the same time introducing a tiered structure, it should be very explicit about what each method of qualifying will allow the investor to do. However, again a better alternative would be to simply remove the tiered structure and make it a binary classification. Either accredited or not, the alternative will only create confusion.

With regard to investment limitations for those accredited investors qualifying at the current levels, the 10 percent figures recommended in the Report are simply not realistic. If an individual qualifies with a salary of $200,000, that means he/she would be limited to $20,000 in investments. These types of investments regularly top $20,000.[2] If the SEC is intent on placing limitations on the size of investments that accredited investors can make, those figures should have a strong correlation to current levels to avoid disrupting the existing market. As SEC has not clearly indicated that the current levels of investment are a problem to be remedied, a market disruption in this way seems unjustifiable.

B. Add New Inflation-Adjusted Income and Net Worth Thresholds that Are Not Subject to Investment Limitations

NSBA is opposed to the bifurcation of the accredited investor definition. Creating a type of accredited investor which has investment limitations, and one which does not have investment limitations needlessly complicates the process of making an offering under Regulation D. The stakes are very high on offerings under Regulation D for small businesses, with the investments made in time and expertise representing an enormous commitment. With the potential to make an entire offering unlawful and trigger extensive regulatory requirements if the non-accredited investors are improperly allowed to participate, the risks for small businesses increase dramatically as the complexity increases.

C. Index All Financial Thresholds in the Definition for Inflation on a Going-Forward Basis.

Indexing the thresholds levels for the accredited investor definition may complicate compliance as the thresholds will change. However, if this recommendation is adopted, it is absolutely essential that the adjustments take place on a fixed schedule so that all those in the community can properly prepare for each adjustment.

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

NSBA supports this change as it would expand opportunities to invest in small businesses to more households.

E. Permit All Entities With Investments in Excess of $5 Million to Qualify as Accredited Investors

NSBA supports this change as it recognizes those with such significant assets invested are both very likely to be sophisticated enough to protect themselves from the risks of the investment and also secure

[2] For instance, most Angel Groups require a minimum investment of $25,000. This would prohibit all those individuals with incomes under $250,000 from being part of an Angel Group. This would shut off educational and mentoring opportunities to those who may benefit the most. While the NSBA would support raising the investment level to 15% of income (less than half these individuals' tax rate of 33% at the $200,000 level for a single person), at a minimum we would like to see the allowable investment to be $25,000 or 10% of income, whichever is greater.

enough to withstand the potential loss of a particular investment. NSBA also supports the expansion of the definition to encompass any entity, regardless of form, which has investments in the requisite amount to qualify. However, this set of recommended changes is also an example of where clarity is critical. If there are two tiers of accredited investor, one with a cap and one without, to which does the $5 million investment criteria qualify the investor?

The potential implications can be seen by examining two hypothetical situations. In the first, having $5 million in investments qualifies the accredited investor for the upper tier of the definition with unlimited investments. This is perhaps what was intended however not clearly enough stated. In that situation, different parts of the recommended changes interact in what is likely an unanticipated way. Here, the cap on accredited investors in the lower tier could dramatically slow an investor's progress towards the $5 million threshold and unlimited investment opportunities. Adopting the recommended change of using the "investments" definition from Rule 2a51-1(b) would be a strong step towards alleviating this concern by taking a broad view of what qualifies towards that $5 million investment threshold.

The alternative situation would be that an investor qualifying through holding $5 million in investments would be placed in the lower tier, which has a cap. In that situation, an investor, for example a limited liability corporation, with over $5 million in investments would be limited in it's investment ability, while an individual accredited investor qualifying into the upper tier through income would be able to invest with absolutely no limitation.

In that situation it seems odd to cap a business entity like a limited liability company while the individual investor is not capped. If the definition is to be tiered, it should be made absolutely clear that entities qualifying through $5 million in investments qualify for the upper tier. These hypotheticals illustrate how necessary it is to define to what tier each criteria qualifies the investor and to put serious thought into how the various parts of the definition work together. Finally, these hypotheticals illustrate how much more complicated the system will be under a tiered approach than the current binary definition of accredited investor.

F. Permit an Issuer's Investors That Meet and Continue to Meet the Current Accredited Investor Definition to Be Grandfathered with Respect to Future Offerings of the Issuers Securities

This recommendation is thoughtful addition and incredibly important to the small business community. Without this change, it is very likely that current investors who in the future may not meet the accredited investor thresholds would be adversely affected.

If a business makes an first offering, and then subsequently decides to make another offering, the initial holders position in the business could be diluted if they are barred from participating. The grandfathered exemption recommended by the Report would preserve the right of an investor, who was previously an accredited investor, to further invest and maintain his/her/its position within the business. Without such an option, investment in small business through these offerings would be less appealing to accredited investors as they face an increased likelihood of dilution.

This exemption is doubly important, if the SEC does indeed fix the thresholds to inflation and bifurcate the definition into upper and lower tiers, which could have the impact of changing an accredited investors ability to invest. If implemented, this recommendation should be made more clear that this would also apply to those who fall from the unlimited investment tier to the lower tier with capped investments. It is certainly conceivable that an investor may make an investment while in the unlimited tier, subsequently fall into the lower tier and then run into a cap preventing them from investing and maintaining their

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position in the business. The possibility of such an occurrence would certainly limit the attractiveness of Regulation D offerings to investors.

2. The Commission Should Revise the accredited Investor Definition to Allow Individuals to Qualify as Accredited Investors Based on Other Measures of Sophistication.

A. Permit Individuals With a Minimum Amount of Investments to Qualify as Accredited Investors

NSBA is concerned with how this change would be implemented within the tiered structure that is proposed within the Report. It appears that it is targeted towards those who have already made a certain level of investments, possibly including exempt offerings. However, the question which is again presented, is to what does this qualify the investor? If this method of qualification allows unlimited investment, then no further clarification is needed.

B. Permit Individuals With Certain Professional Credentials to Qualify as Accredited Investors

NSBA supports this recommendation. This follows the logic that 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. This change may capture professionals who have not yet hit the other thresholds for qualification but possess the knowledge and the will to responsibly invest in these offerings. Again however, it must be made clear if there is to be different tiers of accredited investors, for which tier these credentials would qualify the investor. Would an investor with certain credentials be placed in the upper tier and those investors with other credentials placed in the lower tier? This is the type of situation which could create confusion, despite there being a seemingly bright line test for qualification.

C. Permit Individuals With Experience Investing in Exempt Offerings to Qualify as Accredited Investors.

This recommendation seems to address those who previously qualified as an accredited investor and participated in a certain number of offerings, however subsequently failed to qualify as an accredited investor. If that is the case, then this recommendation recognizes the fact that experience in these type of investments may be a helpful indicator of that investors ability to responsibly invest in exempt offerings. However, it must be clarified what qualification through this manner would allow the investor to do. Would this qualify the investor for unlimited investment or the limited investment indicative of the lower tier of the accredited investor definition?

D. Permit Knowledgeable Employees of Private Funds to Qualify as Accredited Investors for Investments in their Employer's Funds.

NSBA supports expanding the definition in the manner described within this section.

E. Permit Individuals Who Pass an Accredited Investor Examination to Qualify as Accredited Investors

NSBA supports this recommendation. Creating an objective test cuts to the heart of determining the sophistication of potential investors. If that test is housed within a single organization or scores filed with a single organization it would also make the verification of accredited investor status relatively simple.[3] However, if a new test is to be created, we would encourage SEC to initiate extensive dialogue with the community to determine the subject matter, scope, and other details to ensure that it best assesses the ability of investors to participate in the marketplace.

[3] However, as noted below, under the new definition investors should be able to self-certify their status. To do otherwise would open the marketplace to tremendous regulatory compliance burdens.

Additional Changes Not Recommended in Report

In addition to the changes which SEC recommended in its Report, there are a few further changes which NSBA supports making to the accredited investor definition.

A. Self-Certification

First and foremost, under the current system, accredited investors are allowed to self-certify their status as accredited investors. This is essential to minimize the regulatory burdens on making such an offering, especially given the bifurcated structure proposed in the Report. Making a small business or broker responsible for not only determining that investor has the requisite qualifications, but also in some cases, that the investor has not yet hit his/her investment cap for the year would be incredibly burdensome. The investors themselves are in the best position to know if they meet the qualifications for an accredited investor. The investor has access to all of the appropriate documentation that would be time consuming and onerous for a small business to compile. Allowing self-certification is key to the system functioning and keeping these securities a viable option for small businesses looking to raise capital.

B. Retaining Professional Advisors

NSBA supports adding to the definition of accredited investor, a person who has retained professionals qualified to advise on the purchase of these types of securities. The report points to "purchaser representatives" as a way for non-accredited investors to purchase securities with the help of an advisor. However, rather than allowing non-accredited investors utilizing purchaser representatives limited participation in Regulation D offerings as non-accredited investors, the SEC should consider granting those individuals who retain a professional advisor or representative purchaser full accredited investor status.

Hiring those with a fiduciary duty to the investor as well as the professional credentials to advise the investor, is another way to safeguard the investor from the bad actors in the market and from investing unwisely given their individual circumstances. It would also create a repeat player situation in the marketplace where small businesses could potentially deal on a more consistent basis with a smaller number of advisors rather than a much more disparate group of investors.

C. Geographic Disparity

The Report does not adequately deal with the issue of disparate levels of wealth throughout the country. There are certain areas of the country with far more accredited investors than others. It is likely that allowing other measures of sophistication to qualify accredited investors may increase the amount of accredited investors in poorer regions of the country. Nonetheless that will not necessarily address the imbalance in the number of accredited investors between the different regions of the country which means that small businesses in poorer regions of the country will continue to be at a disadvantage. The SEC should continue to think about ways to address this disparity.

Conclusion

NSBA is pleased that the SEC is giving serious thought and consideration into how this definition could be revised and we look forward to a formal comment period on any changes which will be made. We look forward to working with the SEC to find ways to expand small business access to capital as well as increase investor ability to safely invest in small businesses through revision to the accredited investor definition.

Thank you,

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CEO

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