



## PUBLIC INVESTORS ARBITRATION BAR ASSOCIATION

2415 A Wilcox Drive | Norman, OK 73069  
Toll Free (888) 621-7484 | Fax (405) 360-2063  
www.piaba.org

May 17, 2016

Brent Fields, Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-0609

### Re: The SEC Staff's December 18, 2015 Report on the Definition of "Accredited Investor"

Dear Mr. Fields:

Thank you for the opportunity to comment on the Securities and Exchange Commission ("SEC") Staff's December 18, 2015 report, which proposes changes to the definition of an "accredited investor". I write on behalf of the Public Investors Arbitration Bar Association ("PIABA")<sup>1</sup> to comment on this proposal. PIABA is a bar association whose attorneys are committed to representing investors in securities arbitrations. Since its formation in 1990, PIABA has promoted the interests of the public investor in all securities and commodities arbitration forums, while also advocating for public education regarding investment fraud and industry misconduct. Our members and their clients have a strong interest in rules promulgated by the SEC and the Financial Industry Regulatory Authority ("FINRA") relating to both investor protection and disclosure. In support of public investors, PIABA often comments on proposed changes to SEC rules and regulations to ensure protection of the rights and fair treatment of the investing public.

The current report and proposal concern "accredited investor" as defined under Rule 501 of Regulation D (17 CFR § 230.501 et seq.). Reg. D exempts certain transactions from registration requirements of the Securities Act of 1933. The purpose of providing exemptions from registration under Rules 504, 505, and 506 of Reg. D is to allow smaller, private companies to raise capital without incurring the considerable expense and time of complete registration of the offering with the SEC. Since Reg. D investors do not receive the full protection of registration under the Securities Act of 1933, Reg D. private placements can generally only be offered to institutional and certain individual investors who are deemed "accredited" under the Rules. The assumption of Reg. D is that "accredited investors" have both the sophistication to comprehend the risks and characteristics of said limited offerings and also have the financial means to withstand the risks inherent in these securities.

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<sup>1</sup> PIABA is an international bar association, consisting of over 500 members, dedicated to the protection of investors' rights in securities arbitration proceedings.

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Historically, income and net worth thresholds were used to define individual accredited investors. These thresholds were established in 1982, with few modifications since that time. An individual with a net worth in excess of \$1 million, or with an individual income in excess of \$200,000 or joint income with his or her spouse in excess of \$300,000, is an “accredited investor.” However, as more people become millionaires thanks to little more than inflation, there are more people than ever who qualify as “accredited investors,” yet many of these people simply do not have the sophistication to understand the risks associated with private placements to sufficiently protect themselves. According to the SEC’s review, the census data from 1983, a year after the thresholds were established, demonstrated that only 0.5% of households met the individual income threshold, only 1.7% met the net worth threshold, and only 1.8% met either threshold. As of 2013, those numbers have increased to 6.6% for the income threshold, 7.5% for the net worth threshold, and 10.1% for either threshold. Additionally, as a result of the growth of IRAs and similar retirement plans, a significant number of those who qualify on a net worth basis are older and retired.

The “accredited investor” definition is important to investors for several reasons. First, an issuer relies on the definition when choosing investors for the private placement. This is particularly important as offerings under Rule 506 may now engage in general solicitation so long as the securities are only sold to “accredited investors.” Second, brokers rely on the definition of “accredited investor” when determining to which customers to recommend a private placement. Brokers often consider the “accredited investor” definition as synonymous with the suitability standard – if a customer qualifies for the private placement, many brokers wrongly believe the investment is, by definition, an appropriate investment for any investor who qualifies. As the issuer typically does no further due diligence with respect to the investors recommended by brokers, it is essential that an appropriate standard be adopted to protect unsophisticated investors who cannot bear the risk of loss inherent in private placements.

The SEC Staff made several recommendations in reviewing the definition of “accredited investor” as it applies to Reg. D offerings. Currently, there are several ways in which an investor can qualify as “accredited” to invest in Reg. D offerings. As described above, investors often qualify by meeting either the income or net worth thresholds. The SEC is now considering revising these thresholds, as well as other criteria, to qualify an investor as being “accredited”:

- a) The SEC proposes to keep these thresholds intact, but limiting the amount that one could invest by a percentage of his or her income or net worth – for example, being allowed to only invest 10% of income or net worth for any 12-month period;
- b) As an alternative, the SEC proposes to raise the qualification thresholds to \$500,000 for an individual’s income; \$750,000 for a couple’s income; or \$2.5 million for net worth, without any investment limitations based on percentage of net worth or income;
- c) Additionally, the SEC is considering a review of the income and net worth thresholds on an on-going basis;
- d) The SEC has also considered allowing couples to pool their assets to qualify under the net worth threshold;
- e) The SEC also is considering whether to allow others to meet the definition of accredited investor, even if they do not meet the income or net worth threshold, if the investor has experience in investing in those types of securities or has professional experience (such as licensed securities salespersons).

PIABA understands that the current definition of “accredited investor” is outdated. The income and net worth thresholds were established in 1982, almost 35 years ago. The fact that so few households qualified under the original 1982 thresholds suggests that Reg. D investments were meant for a very small percentage of the investing public. The fact that the percentage of qualified households has increased more than five-fold in the last three

decades supports increases to these thresholds. Accordingly, PIABA supports the proposal that raises the net worth threshold (to \$2.5 million) and the income threshold (to \$500,000 for individuals or \$750,000 for couples) for accredited investors. We believe this is more appropriate than merely keeping the present thresholds and limiting the overall investment to a percentage of the income or net worth. The increases will undoubtedly shrink the pool of “accredited investors,” and in so doing, will bring the definition back into line with the original intent of limiting Reg. D offerings to a very small set of American investors.

PIABA welcomes the proposal to increase these thresholds. Many investors are being solicited to invest in private placements or limited offerings when their total net worth is barely \$1 million. As cited by the SEC, over \$1.3 trillion Reg. D investments were issued during 2014 alone. That means that private companies were able to find enough investors to place over \$1.3 trillion in private placements in 2014 alone. However, a large number of these investors cannot afford to take on the risks that are typically associated with Reg. D investments. Most private placements and limited offerings are substantially more illiquid than a publicly traded security, and these private placements often carry with them the risk of total loss of investor funds. One million dollars, while not an inconsequential sum, does not carry the weight that that sum did in 1982 when the accredited investor definition was set forth for the first time. An investor losing a significant portion of a \$1 million thanks to ill-advised Reg. D investments will find it difficult to survive through the course of retirement. Increasing that threshold, while still placing some investor at risk, increases the potential for an investor to be able to withstand a poor Reg. D investment.

Moreover, it is important to note that the current accredited investor standard, in creating a comparatively large pool of investors qualified to be offered Reg. D securities, makes it a particularly attractive tool to promote fraudulent schemes. Investors have seen a string of Reg. D offerings in the last 5 to 10 years that have turned out to be nothing more than Ponzi schemes. Some that come to mind are Medical Capital, Provident/Shale Royalties, and DBSI – all which relied on Reg. D to issue securities. Many clients who were solicited to invest in these products lost their entire investment in these securities and could ill afford those losses. The change in the definition of an accredited investor would limit the number of investors who can invest in these products and will therefore discourage others from using Reg. D to promote fraud, and will accordingly help protect *all* investors from fraudulent offerings.

PIABA also supports a regular review and adjustment of these thresholds. These thresholds should be reviewed every few years and adjusted to account for inflation.

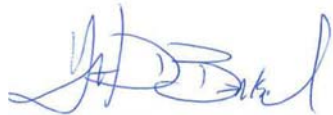
In addition, PIABA believes that there should be some sophistication qualification to be an accredited investor, in addition to the net worth or income thresholds. Investors who otherwise meet the requisite net worth threshold may not be sophisticated enough to appreciate the significant risks of investing in private placements and limited offerings. As such, it makes sense to include some qualification that the accredited investor is also sophisticated enough to gauge these risks, whether it be by their profession or through prior investing experience. However, this sophistication qualification should not replace the income or net worth qualification. Because of the speculative nature of private placements, it is important that investors have the financial means necessary to withstand the risks inherent in these securities.

Last, the SEC needs to make clear to brokers and others who manage client investments that the “accredited investor” definition is not a replacement to the obligation to only make suitable recommendations to clients. Advisors should not be allowed to conflate the suitability standard and the accredited investor standard, as is often done. A simple statement from the SEC that just because an investor qualifies as an “accredited investor” does not mean that the investment is suitable for that customer could go a long way in protecting public investors who, even with \$2.5 million in net worth, still need protection from the SEC.

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In sum, PIABA supports any proposal that raises the net worth and income thresholds to qualify as an accredited investor. I want to thank you for the opportunity to comment on these recommendations.

Sincerely,

A handwritten signature in blue ink, appearing to read "H. Berkson". The signature is fluid and cursive, with a large initial "H" and a long, sweeping tail.

Hugh D. Berkson, President