June 29, 2016

Via Electronic Submission (www.sec.gov)

Mr. Brent J. Fields, Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Report on the Review of the Definition of "Accredited Investor"

Dear Mr. Fields:

The Investment Adviser Association[1] appreciates the opportunity to comment on the report issued by the staff of the Securities and Exchange Commission regarding the "accredited investor" definition ("Staff Report"). The IAA commends the staff for the comprehensiveness of the review and commends the Commission for seeking public comment on it as it considers whether and how to modernize the definition of accredited investor.

We are disappointed, however, that the recommendations in the Staff Report do not include an approach whereby a person could qualify as an accredited investor if that person has retained the services of a registered investment adviser to act as a fiduciary in managing his or her investments. The IAA has long supported this approach, and we respectfully submit that if and when the Commission proposes amendments to the definition of accredited investor, it should consider this means to qualifying investors to invest in private offerings.[2]

Background and Summary of Position

Regulation D under the Securities Act of 1933 ("Securities Act") is a critical exemption available to issuers of private offerings and is designed to facilitate capital formation by simplifying existing regulations and eliminating unnecessary regulatory burdens on issuers. As noted in the Staff Report, the "accredited investor" definition is the central component of Regulation D and enables investors who fall within the definition to participate in investment opportunities that are generally not available to non-accredited investors. Currently, financial thresholds based on income and net worth have to be met to qualify as an accredited investor.

[1] The IAA is a not-for-profit association that represents the interests of investment adviser firms registered with the U.S. Securities and Exchange Commission. The IAA's membership consists of approximately 600 firms that collectively manage nearly $20 trillion for a wide variety of clients that are individual and institutional investors, including pension plans, trusts, investment companies, private funds, endowments, foundations, and corporations. For more information, please visit www.investmentadviser.org.

[2] *See* Letters to SEC from Investment Adviser Association, dated Sept. 23, 2013 and Mar. 9, 2007.

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") requires the Commission to conduct a comprehensive review of the accredited investor definition as applied to natural persons at least once every four years and then permits the Commission to consider whether the definition should be "modified or adjusted for the protection of investors, in the public interest and in light of the economy."[3] The outcome of the Commission's deliberations will have significant implications for many investment advisers, including those that manage hedge funds, private equity funds, and venture capital funds or recommend private offerings to their clients.

At its core, the accredited investor definition is intended to identify investors who are able to "fend for themselves" and bear the economic risk of investing in private offerings, and thus do not need the protections afforded by the full panoply of federal securities laws. We continue to believe that investment advisers retained by investors to manage their assets on a discretionary basis, and pursuant to a fiduciary duty, provide precisely the type of protections intended by the definition.[4] The current standards disregard this fact, and in doing so unduly restrict investment opportunities for the large number of investors who have engaged investment advisers to determine whether opportunities are in their best interest. We believe that expanding the definition to include these types of investors is consistent with all of the Commission's objectives and goals here—it would continue to protect investors, while also providing clarity for market participants and promoting the supply of capital in the private offering market.

Investors that use registered investment advisers to manages investments on a *discretionary basis* and *pursuant to a fiduciary duty* should qualify as accredited investors.

We propose that the Commission amend the definition of accredited investor to include investors whose relevant investments are made by the SEC-registered investment advisers they retain, as fiduciaries, to manage their investments on a discretionary basis. For reasons explained more fully below, we believe that a registered investment adviser is an appropriate

[3] *See* Section 413(b)(2) of the Dodd-Frank Act [Pub. L. No. 111-203, 124 Stat. 1376 (2010)]; Staff Report at 4. The Staff Report also addresses how the definition has been applied to entities not specifically covered by one of the enumerated categories under the rules (*e.g.*, limited liability companies, certain other governmental entities and educational expense "529" plans. *See, e.g.*, Alaska Permanent Fund, SEC Division of Corporation Finance Interpretive Letter (July 14, 2011). We agree with commenters that have expressed the concern that not enumerating these and other legal entities in the definition has led to some degree of uncertainty as to whether they may qualify as accredited investors or as qualified institutional buyers under Rule 144A ("QIBs"). The same principles justifying our recommendation regarding natural person investors would apply to entities that have retained the services of an investment adviser, and we urge the Commission to clarify that both an entity and a natural person that has an investment adviser acting on their behalf would qualify as an accredited investor. And, although not the focus of the staff's recommendations, we encourage the Commission to apply the same analysis and reasoning to QIBs. In our view, entities that satisfy the $100 million in securities of unaffiliated issuers component of the QIB definition in Rule 144A(1)(i) and that have investment advisers acting on their behalf should qualify as QIBs.

[4] We do not specifically address the SEC staff's recommendations, except that we support the recommendation that knowledgeable employees of private funds should be deemed accredited investors.

proxy for an investor's own investment experience and satisfies the Commission's goals in ensuring that investors are adequately protected and able to bear the economic risk of those investments.

The accredited investor standard is designed, in part, to provide assurance that an investor has a requisite level of sophistication—in a sense, the capacity to understand the nature of a private placement and the differences in disclosure from a public offering, and the wherewithal to request and obtain additional information as necessary to evaluate the merits of the investment. Advisers serve precisely this function for their clients.

In managing assets on a discretionary basis, advisers have the authority to make investment decisions on behalf of their clients. Such advisers may discuss the merits and risks of potential private fund investments with their clients before making the investment, and clients will sign the subscription agreement and other documents as appropriate. In so doing, clients may acknowledge that the adviser is their representative during the course of the purchase of an investment.

We suggest that the concern about these investors fully appreciating the risk of these investments should be greatly alleviated by the fact that SEC-registered investment advisers are obligated to place their clients' interests above their own. An investment adviser stands in a special relationship of trust and confidence with, and therefore is a fiduciary to, its clients.[5] As a fiduciary, an investment adviser has an affirmative duty of care, loyalty, honesty, and good faith to act in the best interests of its clients. The parameters of an investment adviser's duty generally include: the duty at all times to place the interests of clients first; the duty to have a reasonable basis for its investment advice; the duty to make investment decisions consistent with any mutually agreed upon client objectives, strategies, policies, guidelines, restrictions and acceptable levels of risk; the duty to treat clients fairly; and the duty to make full and fair disclosure to clients of all material facts about the advisory relationship, particularly regarding conflicts of interest.[6]

Moreover, the fiduciary duty of SEC-registered investment advisers provides substantial protections for their clients.[7] Specifically, in the course of their duties, investment advisers conduct research and due diligence on hedge funds, private equity funds, and venture capital funds, among others, on behalf of their clients before making an investment for them. The

[5] *See SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 191-92, 201 (1963).

[6] *Id.*; *see also In re Arleen Hughes*, SEC Release No. 34-4048 (Feb. 18, 1948); IAA Standards of Practice, as amended February 28, 2006, available at: https://www.investmentadviser.org/eweb/dynamicpage.aspx?webcode=StandardsPractice.

[7] In addition, SEC-registered investment advisers are subject to Commission examinations under the Investment Advisers Act of 1940. They are also obligated to adopt and implement written policies and procedures reasonably designed to prevent violation of the Advisers Act, review those policies and procedures annually, and designate a chief compliance officer to be responsible for administering the policies and procedures. *See* Rule 206(4)-7; *Compliance Programs of Investment Companies and Investment Advisers*, SEC Release Nos. IA-2204; IC-26299; File No. S7-03-03 (Dec. 17, 2003).

recommendations or investments are vetted by advisers after satisfying their duties to make investment decisions in the best interest of their clients. In addition, advisers are required to understand the complexities and risks of any investment vehicle in which they invest their clients' assets and determine that the investments are suitable. To fulfill the obligation, an adviser will make a reasonable determination that the investment advice provided is suitable for the client based on the client's financial situation, investment objective, and tolerance to risk. This unique relationship should satisfy the Commission that these investors are appropriately protected and able to bear the risk of investments.

We disagree with the SEC staff's assertion that permitting the use of investment advisers would be inconsistent with the use of a "purchaser representative."[8]

In determining not to recommend the use of professionals[9] as a means to qualifying as an accredited investor, the staff was concerned that this approach would appear to "run counter to the Commission's prior determination to allow [non-accredited persons] to participate in [private] offerings" where a purchaser representative is able to evaluate additional financial information about the issuer.[10] We do not see our recommendation as inconsistent with the Commission's prior decision, but rather an expansion of the same concept. The current framework allows a purchaser representative to provide the "sophistication" necessary to demonstrate that a non-accredited investor has sufficient knowledge and experience in financial and business matters to make them capable of evaluating the merits and risks of the prospective investment, but only applies with respect to the 35 non-accredited investors permitted to participate in a private offering under Rule 506. Extending this concept to apply more broadly is precisely the type of change that would more closely align the definition of accredited investor with concepts of sophistication, as opposed to the arbitrary nature of the current net worth thresholds.

We believe that investment advisers are, in essence, the most effective type of purchaser representative. They are obligated to perform due diligence in evaluating the merits and risks of private offerings on behalf of their clients. In fact, we believe that investment advisers, as fiduciaries, have a broader mandate in evaluating the merits and risks of private offerings on behalf of their clients relative to other "professionals," including purchaser representatives. Also, given the proliferation of the availability of information in recent years, advisers are in a

[8] Securities Act Rule 506(b). The Commission has stated that purchaser representatives may be investment advisers. *See Interpretive Release on Regulation D*, SEC Release No. 33-6455, 1983 WL 409415 (Mar. 3, 1983) at 7, n. 24 (citing SEC no-action letters Winstead, McGuire, Sechrest & Trimble (pub. avail. Feb. 21 and Mar. 25, 1975) and *re Kenisa Oil Company* (pub. avail. May 6, 1982)).

[9] In considering this approach, the SEC staff used the term "professionals" broadly encompassing, for example, "licensed" experts, financial advisers, and accountants.

[10] Staff Report at 62. *See* Rule 502(b) (specifying the information an issuer must provide to purchaser representatives of non-accredited investors).

better position than most purchaser representatives to access and assimilate this vast trove of data into their due diligence processes.[11]

The SEC's examination staff published a report in 2014 summarizing their findings on the "widespread" due diligence practices of investment advisers that we believe reaffirmed this broader mandate.[12] In particular, the SEC staff observed that advisers are "seeking more and broader information and data directly from managers of alternative investments" and that they are "performing additional quantitative and risk measures" on these investments. The staff also observed that advisers are "enhancing and expanding their due diligence processes and focus areas" to include, for example, onsite visits to provide increased access to review relevant documents. In particular, the staff observed that advisers have expanded their review of audited financial statements of private alternative investments.

Moreover, the Commission's Investor Advisory Committee essentially recommended imposing obligations on purchaser representatives that are on par with those already imposed on investment advisers. Specifically, the Committee suggested that if "investor protections associated with reliance on a recommendation from a purchaser representative" were strengthened, the "Commission could consider permitting individuals to qualify as accredited through a similar means of relying on the recommendation of a fiduciary adviser with no direct or indirect financial stake in the offering."[13] The strengthened protections recommended by the Committee include prohibiting purchaser representatives from having any personal financial stake in the investment being recommended, prohibiting purchaser representatives from accepting compensation from the issuer, and requiring purchaser representatives who are compensated by the purchaser to accept a fiduciary duty to act in the best interests of the purchaser. As noted below, these protections are central to an investment adviser's fiduciary duty to clients which includes an obligation to make full and fair disclosure to clients of all material conflicts of interest.[14]

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[11] We also note that Regulation D does not exempt private offerings from the anti-fraud provisions of the federal securities laws. Moreover, managers of these offerings have a duty to disclose to investors all material information so as not to make disclosures (*e.g.*, private placement memoranda) misleading.

[12] *See* National Exam Program Risk Alert, *Investment Adviser Due Diligence Processes for Selecting Alternative Investments and their Respective Managers* (Jan. 28, 2014). For purposes of the Risk Alert, "alternative" investments included private funds such as hedge funds, private equity, venture capital, real estate, and funds of private funds. Available at https://www.sec.gov/about/offices/ocie/adviser-due-diligence-alternative-investments.pdf.

[13] Recommendation of the Investor Advisory Committee: Accredited Investor Definition (Oct. 9, 2014), available at http://www.sec.gov/spotlight/investoradvisory-committee-2012/accredited-investor-definition-recommendation.pdf.

[14] Moreover, Section 206(3) of the Advisers Act prohibits an adviser, acting as principal for its own account, from knowingly selling any security to or purchasing any security from a client for its own account, without disclosing to the client in writing the capacity in which it (or an affiliate) is acting and obtaining the client's consent before the completion of the transaction.

A purchaser representative is required to have such knowledge and experience in financial and business matters that he or she is capable of evaluating the merits and risks of the prospective investment. Likewise, a registered investment adviser has knowledge and experience in financial and business matters and is capable of evaluating, and does evaluate, the merits and risks of prospective investments for its clients. In addition, a purchaser representative is obligated to disclose to the purchaser in writing any material relationship between himself or his affiliates and the issuer or its affiliates that then exists or that has existed at any time during the previous two years, and any compensation received or to be received as a result of such relationship.[15] Similarly, a registered investment adviser is required to make disclosures regarding material conflicts of interest it has in relation to its position for the accredited investor.

The SEC staff also expressed concern that there "may be significant overlap between individuals who receive advice from professionals and those who meet the existing financial standards in the accredited investor definition."[16] We submit, however, that any duplication would be beside the point and should not be a basis for denying investment opportunities to investors who have retained the services of an investment adviser but who do not otherwise meet the financial thresholds to qualify as an accredited investor.[17]

The GAO study regarding the accredited investor standard found that the use of registered investment advisers could balance the goals of investor protection and capital formation.

We submit that incorporating the use of a registered investment adviser into the accredited investor standard would be consistent with the Commission's interest in balancing the goals of facilitating capital formation and protecting investors. In 2013, the U.S. Government Accountability Office (GAO) published a report regarding its study mandated by the Dodd-Frank Act on the appropriate criteria for determining the financial thresholds or other criteria needed to qualify for accredited investor status and eligibility to invest in private funds.[18] According to the GAO, the use of a registered investment adviser could balance investor protection concerns with the policy objective of facilitating capital formation and be relatively feasible to implement.

Specifically, the GAO found that a majority of market participants in the GAO's study[19] selected the use of a registered investment adviser as the most important criterion with respect to

[15] Securities Act Rule 501(h)(4).

[16] Staff Report at 62.

[17] We note also that the use of purchaser representatives is limited to Rule 506(b) offerings and even then is limited to no more than 35 investors. Moreover, we note that the concern over duplication may also apply were the Commission to expand the accredited investor definition pursuant to the staff's recommendations but leave the financial thresholds in place.

[18] *See U.S. Government Accountability Office Report, Alternative Criteria for Qualifying as an Accredited Investor Should Be Considered* (July 2013), available at http://www.gao.gov/products/GAO-13-640.

[19] The IAA participated in the GAO's study, along with 27 market participants and six other trade associations. The market participants were categorized into four groups intended to represent different segments of the accredited investor population: (1) attorneys who have experience in private placement

measuring investors' understanding of financial risk. Study participants also noted that adding the use of an adviser to the current standard would strengthen investor protection because advisers have a duty to examine the financial needs of their clients. In addition, most market participants believed that "having a registered investment adviser criterion would be feasible to implement and that the market would be willing to accept it." For example, some participants noted that this criterion could be feasible to implement because advisers were already registered and subject to regulation. Others believed having an adviser would be a "practical and objective way to approximate understanding of financial risk." Accordingly, we recommend the Commission consider the GAO's recommendations for alternative criteria for the accredited investor definition, such as an investor's use of a registered investment adviser.[20]

The Commission has acknowledged that the protections provided by the fiduciary duty to investors materially reduce the need for the protection of a higher accredited investor standard.

The Commission has previously acknowledged that an adviser's fiduciary duty to clients could materially reduce the need for the adviser's clients to individually meet the accredited investor standard. For example, the Commission recognized that pension plan fiduciaries can appropriately determine whether to invest in private pools, consistent with the protection of plan participants:

> [N]atural persons may have indirect exposure to private pools as a result of their participation in pension plans and investment in certain pooled investment vehicles that invest in private pools. Such plans and vehicles are generally administered by entities of plan fiduciaries and registered investment professionals. *This protection is not present in the case of natural persons who seek to invest in 3(c)(1) Pools outside of the structure of such pension plans and pooled investment vehicles.*[21] *[Emphasis added]*

We respectfully submit that an investor's retention of a registered investment adviser provides the same level of protection as a plan fiduciary or "registered investment professional" previously cited with approval by the Commission.[22]

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transactions, (2) accredited investors who invest in private placement securities, (3) retail investors who meet the current accredited investor criteria but do not actively invest in private placement securities, and (4) investment advisers and broker-dealers who work with accredited investors.

[20] We also recommend that the SEC consider the GAO's other recommendation regarding a liquid investments requirement (that is, a minimum dollar amount of investments in assets that can be easily sold, are marketable, and the value of which can be verified by a financial institution).

[21] *See Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles; Accredited Investors in Certain Private Investment Vehicles*, SEC Release No. 33-8766; IA-2576; File No. S7-25-06 (Dec. 27, 2006), available at http://www.sec.gov/rules/proposed/2006/33-8766.pdf, as published in 72 Fed. Reg. 400 (Jan. 4, 2007).

[22] *See also* President's Working Group on Financial Markets, Agreement Among PWG and U.S. Agency Principals on Principles and Guidelines Regarding Private Pools of Capital, at section 5 (Feb. 22, 2007), which noted that fiduciaries that manage pension funds, fund-of-funds, or other similar pooled investment vehicles "have a duty under applicable law to act in the best interest of the beneficiaries. They have an

The Commission should carefully consider the regulatory burdens of any change to the accredited investor definition.

As the Commission considers our recommendation and the wide range of other suggestions in the Staff Report, we urge that it carefully consider the regulatory burdens that would be placed on issuers with respect to each such change in the accredited investor definition. We agree with the staff that the "need for clarity in the definition is particularly important because an issuer relying on an exemption from registration carries the burden of proving that the exemption is available." Regulation D was "adopted, in part, to bring a greater degree of clarity for small businesses" and is a "fundamental objective of the accredited investor definition." We believe that permitting the use of a registered investment adviser would provide certainty as a "bright-line [test] that allow[s] market participants to readily determine an investor's status under the definition" and would impose relatively fewer regulatory burdens on issuers.

* * *

Many investors have retained registered investment advisers to make investments on their behalf as fiduciaries, including in the types of investments that are currently only available to investors who fall within the current accredited investor definition. Accordingly, the Commission should acknowledge this protection and adopt an accredited investor standard that expressly includes investors who hire an investment adviser registered with the Commission to manage their accounts on a discretionary basis.

We appreciate your consideration of our comments on this important matter. Please do not hesitate to contact us if we may provide any additional information or assistance to you during this process. Please contact me or Sanjay Lamba, IAA Assistant General Counsel, at [redacted] with any questions regarding these matters.

Respectfully,

/s/

Robert C. Grohowski
General Counsel

cc: The Honorable Mary Jo White, Chair
The Honorable Kara M. Stein, Commissioner
The Honorable Michael S. Piwowar, Commissioner
Keith F. Higgins, Director, Division of Corporation Finance
Sebastian Gomez, Chief, Division of Corporation Finance

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ongoing responsibility to perform due diligence to ensure that their investment decisions are prudent and conform to sound practices for fiduciaries." Advisers, as fiduciaries, provide the same level of protection and similar functions with respect to their clients' investments.